The Transfer of Undertakings with specific reference to the transfer of insolvent undertakings

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An Evolution of the South African Law

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Declaration

I, the undersigned, hereby declare that the work contained in this thesis is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

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Summary

The freedom to transfer an undertaking is part of the employer's freedom of contract. The transferee of an undertaking under the common law has the right to choose whether he wants to contract with employees or not.

By the implementation of section 197 of the Labour Relations Act (1995) and the amended sections 197, 197A of the Labour Relations Act (2002) the legislator provides for an automatic transfer in cases where the undertaking is transferred as a going concern. The former accordance with the regulations of the insolvency law and the fact that sequestration or the winding-up of an insolvent undertaking had to be to the advantage of the creditors was lost after the legislative steps of 1995.

The effects of the above-mentioned sections and especially the problems regarding the transfer of insolvent undertakings shall be analysed in this thesis. It is the aim of this thesis to examine how sections 197, 197A of the Labour Relations Act and section 38 of the Insolvency Act should be applied and interpreted to achieve social justice. This makes it necessary to examine the history and development of the South African law of transfer of an insolvent undertaking too.

Section 197 of the Labour Relations Act is mostly based on European law. Although it is not the intention of this thesis to compare the European law with the South African law, several South African aspects will be examined from a European and especially German perspective.

Opsomming

Die vryheid om 'n onderneming oor te dra, vorm deel van die werkgewer se regte om te kontrakteer. Die oordrag van 'n onderneming ingevolge die gemene reg, het aan die nuwe werkgewer die keuse gelaat om te kies of hy wel 'n kontrak met die werknemers wil sluit of nie.

Met die implementering van artikel 197 van die Wet op Arbeidsverhoudinge (1995) en van artikels 197, 197A van die Wet op Arbeidsverhoudinge (2002) het die wetgewer voorsiening gemaak vir automatiese oordrag in gevalle waar die onderneming oorgedra is as 'n lopende saak. Die voormalige ooreenstemming met die regulasies van die insolvensie wet en die feit dat sekwestrasie of afsluiting van 'n insolvente onderneming bepaal het dat krediteure tot voordeel strek, het verlore geraak na die wetgewende stappe van 1995.

Die uitwerkings van die bogenoemde artikels en veral die probleem met betrekking tot die oordrag van 'n insolvente onderneming sal in hierdie tesis geanaliseer word. Dit is die doel van hierdie tesis om te beoordeel hoe artikel 197, 197A van die Wet op Arbeidsverhoudinge en artikel 38 van die Wet op Insolvensie toegepas en geïntepreteer moet word om sosiale geregtigheid te bereik. Dit maak dit ook noodsaaklik om die geskiedenis en die ontwikkeling van die Suid-Afrikaanse reg met betrekking tot die oordrag van 'n insolvente onderneming te ondersoek.

Artikel 197 van die Wet op Arbeidsverhoudinge is gebaseer op Europese wetgeving. Alhoewel die dissertasie nie die intesie het om die Suid Afrikaans reg met die Europese reg te vergelyk nie, sal sommige Suid Afrikaanse aspekte vanuit die Europese en spesiaal Duitse perspektief ondersoek word.

Loof die Here, want Hy is goed,
aan sy liefde is daar einde nie.

Give thanks to the LORD, for he is good;
his love endures for ever.

Psalm/s 118, 1

This dissertation is dedicated to my parents, Ursula and Dieter Spree.
I am very grateful for their guidance, support and love during my whole life.
Without the support of my whole family neither my studies in the fields of Music and Law nor the stay in South Africa would have been possible.

Table of Content

Introduction

A has run a small establishment with ten employees for a few decades. Most of his employees have been working for him for a number of years. A would like to retire. But he does not want to close the establishment just because of his retirement. On the contrary, he wishes that someone would continue to run "his" establishment. However, none of his sons, just to use this old-fashioned picture, want to succeed him in the business. A started looking for a successor who would like to buy the establishment and found a potential buyer, B.

In this simple and everyday situation, the different interests of the three acting parties, A, B and A's employees, can be recognised easily.

A would like to earn the best possible price for the sale of the assets. Probably he prefers that B would take over the whole establishment, i.e. the assets as well as all of his employees who served him during the years.

Of course, B wants to pay as little as possible, notwithstanding his interests in the deal. Especially with respect to A's workforce, he could have other plans than just to take over all ten employees. If he already works in this area, he could think about running the business with some of his own employees instead the ten employed by A. B could have the intention to buy the establishment just to take over a competitor and to close it afterwards. As a third possibility, B could be interested in drawing on the knowledge of some or even only one of A's employees. In any case, several reasons could lead to various answers to his question whether and which employees he wants to take over. B's questions definitely cannot be answered by ordinary statutory regulations. First of all, B needs to find the answers from a purely economic point of view. Only a small number of statutory regulations would correspond with his own business plan, while other regulations could infringe on their freedom of contract, on the one hand, and the system of free markets, on the other hand.

For A's employees, several problems will arise in this situation too. They probably contracted with A, because they wanted to serve him and not another employer. In such circumstances it could be disadvantageous for them if they would be forced to serve B. Especially in times with high unemployment rates, they would rather be concerned about the protection of their current status of employment than with the person of the employer. However, the transfer of A's undertaking to B will have consequences for them, either in a more personal or in an economic form.

A's employees as well as B could face further problems. If A's employees would not fit his business plan, B could think about dismissals prior to, or after, the transfer of the establishment. In cases of insolvency the question arises whether the employment contracts will not be terminated at a certain point by an act of law or by the trustee. The difficulties with dismissals in particular as well as in transfer situations will be considered in each of the three chapters.

Because of the danger of losing their jobs and probably livelihood, A's employees will be interested in disclosures of information by A. Only if A would disclose information about the status of the establishment or his plans to resign, could they think about looking for other employment. In a second step, they could think about getting involved in negotiations between A and B, or try to negotiate with A or B to find solutions for their employment future. Each of the three chapters will examine the basic regulations and the courts' opinions, because the South African law has of course also changed in this regard during the last years. The reason for several changes becomes evident if one keeps in mind the great efforts of South Africa to become a democratic state.

The problems regarding the transfer of a solvent undertaking will increase in situations where this undertaking is insolvent or in danger of being wound-up. If A would be insolvent, his creditors will also claim their rights. They are first and foremost interested in getting the highest possible dividend. Especially between 1995 and 2002, the statutory regulations did not resolve the different conflicts well, and this lead to critique from academics and judges as well as to difficulties for practitioners. An examination of the transfer of insolvent undertakings would not be possible without the knowledge of the basic institutes and regulations of South African insolvency and company law. Due to the different interests and developments of the law, each chapter will be divided in three main parts. The first part will consider the labour relation during the examined period, the second subdivision will sketch developments and instruments of the insolvency law, and finally, the third part of each chapter will examine the South African law of transfers of (insolvent) undertakings in detail. Only the chapters One and Three will contain detailed examinations of insolvency and company law with respect to the employment contracts in transfer of undertaking matters, because the chances in 1995 mainly occurred in respect to the South African labour law.

Of course, it is not only the problems with small businesses as in the example, but even more the high number and fundamental importance of mergers and acquisitions (M&A) over the last several years that focus attention on the great importance of finding solutions or even drawing up statutory regulations for transfer of business matters. Also, labour relations are of great importance for the society as a whole, because a great number of people in society are involved in such a relationship. This applies not only to the importance of the relationship between these partners themselves, but also for other stakeholders such as industrialists, business people and personnel officers. As a result of the economic developments during recent years and the increasing competition on the globalised market, employment law has developed significantly. These developments have been characterised by tension between the demand for flexibility imposed by the system of free markets, and the demand for protection of employment beyond that provided by ordinary contractual principles.[1] However, these clashing interests have to be balanced. Where commercial efficiency must be married with fair labour practices, compromises are necessary.[2] These compromises cannot always be found by the parties concerned, because often one party will find itself in a weaker position. It is questionable if the legislator could assist the parties concerned to find a fair balance of their interests.

The thesis will consider the developments in this field of law during recent years mostly from a historical point of view. The opposite perspective, the examination of the effects of the statutory regulations, could not be addressed within such a thesis, because of the following problems. Denmark and Germany have similar regulations in respect of the transfer of undertakings. Both sets of regulations are in accordance with the European Acquired Rights Directive.[3] Although the legal consequences for the employment contracts in transfer of undertaking matters are similar, their unemployment rates differ significantly.[4]

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[1] Todd C *et al*, *Business Transfers and Employment Rights in South Africa*, 1.

[2] Todd C *et al*, *Business Transfers and Employment Rights in South Africa*, 3.

[3] The landmark Directive 77/187/EEC, the so-called EC Acquired Rights Directive (ARD) was drafted by the Directorate General V, an agency of the Commission as a part of the Social Action Programme of the EEC of 1974 – Abl. EG Nr. L 61/26.; Directive 2001/23/EC succeed 98/50/EC , the successor of 77/187/EEC; see further *supra*.

[4] In December 2005 Denmark had an unemployment rate of 4,4 % and Germany of 9,1 % - Source: Eurostat, Press release 25/2005, 1; Several authors and practitioners call the German regulation for the transfer of employment contracts a "Jobkiller",(See Schiefer B, Tarifwechsel beim Betriebsübergang– neue Möglichkeiten? (2003) *Der Betrieb*, 390, 390; See also the respondent in (BAG) 4 AZR 18/00 – Press release 57 of 2000 of the German Federal Labour Court (BAG)) although the regulation has the aim to protect employment.

Or, from a different perspective, Denmark and the USA have almost similar employment figures,[5] but their philosophies of job protection are diametrically opposed. Where Denmark has the above-mentioned system of job protection in accordance to the ARD, the US's system is mainly based on an at-will basis. It seemed to be clear that an examination of the effects of a single regulation, e.g. section 197 LRA (1995), in respect to the economy or management would serve no purpose within such a thesis. Every single employer has to make his decisions within a framework of different and numerous regulations, especially in the field of business law and, even more, tax law. The effect of a single regulation within this framework for the decisions of an employer is in most cases not considerable, even with an evaluation of the opinions of a certain group of employers. Even if a government has the intention to protect jobs,[6] a single regulation can only be one stone of the mosaic that builds the legal framework for the deciding entrepreneurs. This makes a serious examination of just one regulation futile.

Because of these problems, this thesis tries to achieve an understanding of the South African law of transfers of undertakings by a historical approach through the three chapters. However, the consideration of statutory provisions that deal with the transfer of undertakings makes it necessary to take the legislative steps and backgrounds into account.[7] That is why the struggle of the South African legislative and judicial power to balance the described clashing interests during recent decades will be examined. The knowledge of the South African historical background will help to understand the intentions of the legislation and certain decisions of the courts in these regards. The current South African law has the burden of the legacy of apartheid. Especially in the field of employment law the developments in the 1990s can not be understood properly without a knowledge of the developments in the 1970s. Because of the strong links of labour relations and society as a whole, it is useful to examine the surrounding developments of the society.

Chapter One will examine the legal consequences for employees and employers under common law when undertakings were transferred under solvent as well as under insolvent circumstances. This chapter will give a summary of the situation that Black employees faced during the last decades of the apartheid government too. The approach to the situation prior to 1995 requires

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[5] See Footnote 4; in October 2005 the unemployment rate of the USA was 5,0 % - Source: Eurostat, Press release 153/2005, 1.

[6] Just to point it out, the protection of the employment of already employed people is not the same as the improvement of the total number of employed people, i.e. the reduction of the unemployment rate. Different problems certainly require different approaches to a solution.

[7] Smit N, *Labour Law implications of the transfer of an undertaking*, 24.

consideration of the fundamental legal nature of the relationship between employees and employers as well as the consequences of these relations. An examination of the Industrial Court's establishment of the unfair labour practices jurisdiction will show its struggle to improve the legal situation of employees in transfer of undertaking matters.

As a consequence of this jurisdiction and experiences abroad, the South African legislator tried to regulate these problems within the Labour Relations Act 66 of 1995,[8] which will be considered in Chapter Two. The implementation of this Act was also a result of developments in South African labour law during the last three decades and changes in South African society in the 1990s. However, the wording and effect of section 197 of the LRA (1995), which regulates the transfer of solvent and insolvent undertakings, were rather unclear and followed by a string of critical academic articles and different decisions of South African courts. The manner chosen by the South African legislature to regulate the transfer of undertakings after 1994 was adopted from the already mentioned ARD, as stated in *Schutte & Others v Powerplus Performance (Pty) Ltd & Another*[9] and numerous other decisions of the South African courts, as will be considered *infra*. The developments, current status and problems of the South African law dealing with these matters shall not be examined in regard to this key source but first of all in regard to South African experiences and developments. According to *Wallis,* South African labour legislation is first and foremost a product of the South African experience and the problems which were encountered in South Africa.[10] However, for a better understanding of the text of section 197 LRA and problems with its application, Chapter Two will also give a short summary of the European and German legislation, because section 197 LRA (1995) was mostly based on the Acquired Rights Directive of the European Community. Several references to the jurisdiction of the European Court of Justice will follow in the applicable parts of the examination of the South African law. But despite of these references, this thesis does not have the aim to compare South African and European law. Neither the legislation nor the decisions of the courts will be compared under a descriptive, typological or functional methodology. The main focus remains the evolution of the South African law in respect of the transfer of insolvent undertakings.

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[8] Hereinafter the LRA (1995).

[9] (LC) in *ILJ* 1999, 611 at para. 32.

[10] Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 1.

Chapter Three will deal with the current legal situation starting in 2002. Since then the amended sections 197, 197A and 197B of the Labour Relations Amendment Act 12 of 2002[11] have regulated the transfers of undertakings matters. Although these amendments tried to resolve the problems of the regulations of 1995, numerous problems remained unresolved and other problems were created by the amendments.

Finally, other authors, especially in other legal and cultural systems, will certainly emphasise different problems and examine the evolution of the South African law from other perspectives. That is why this thesis is just one possible look at the changes of the South African law during recent decades. Also, because of its limited scope, it can never satisfy any expectations for an all-encompassing account of the evolution of this field of South African law. That is why it is only *an* evolution, just one possibility to summarise and consider the developments that led to the current legislation.

[11] Hereinafter the LRA (2002).

1) Chapter One – Situation prior to 1995

1.1) The South African Labour Law prior to 1995

The most important current statutory regulation of South African labour law is the Labour Relations Act 66 of 1995 (hereinafter LRA (1995)). But despite the tremendous changes in South African society and law during recent years, the changes in the field of labour law already had their roots on the decades before 1994. Important transformations in South African labour law in respect of democratisation and social protection of the workforce already took place under the governments of PW Botha and FW de Klerk.

The developments of labour relations[12]

The important predecessor of the LRA (1995) was the Industrial Conciliation Act 11 of 1924, which repealed the Industrial Disputes Prevention Act 20 of 1909. During the 1920s a need for white employees to secure their advantage above the non-white employees was apparent.[13] To protect white workers, black workers were denied freedoms and individual rights. Based on the regulations of section 24 of the Industrial Conciliation Act 11 of 1924, black workers were excluded from the definition of workers and therefore also excluded from employees' rights. Whereas their white colleagues had individual and collective rights – e.g. to become members of any trade union, to be represented by a council to reach collective agreements with their employer – the non-white employees were excluded from such rights. Because of the elimination of collective representation and bargaining, the employers were able to employ black workers without an appreciation of the terms set out in industrial councils or conciliation board agreements.[14] The lack of individual rights and the disadvantageous status of black workers within labour relations were only one part of the racial exclusivity of the whole society. Despite the status of black workers, one must keep in mind that the pluralistic or tripartite system, i.e. the rule-making power of employees, employers and the state, was normal practice in South Africa.[15] The liberalisation of labour relations during recent years heralded fundamental changes in South African society as a whole.

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[12] The following consideration can not satisfy expectations to an all encompassing picture of the South African society, because the developments were much to complex for a detailed examination. It just tries to sketch the situation of the South African economy and of the majority of workers.

[13] Öztürk I, *German and South African Strike Law*, 10.

[14] Report of the Industrial Legislation Commission (UG 37-1935), section 441.

[15] Wiehahn NE, *The Complete Wiehahn Report* 9.

In the decades following the implementation of the LRA (1956), the South African economy and the legal framework described above came under pressure. This was not only because of the discrimination against black workers and because of their fight against it, but also by disadvantageous developments in the South African economy compared with foreign economies. Although the worldwide economy faced a boom, the South African economy grew much more slowly and wages remained low. Because of this disadvantageous situation, the South African economy faced much pressure within international markets. That is why the government reacted and passed the Black Labour Relations Act, 1973.[16] This Act allowed black workers to communicate with their employers through liaison committees.

On one hand, the racial system remained unchanged and the response was international economic sanctions and disinvestments.[17] On the other hand, a wave of strikes by black and Indian people in Durban in January 1973 had an impact on society.[18] Job reservation, which represented the strongest restrictions of the labour force for ideological reasons, made the South African economy increasingly uncompetitive. Because of these conditions, the race-based and undemocratic labour relations system had to be reformed. The strikes in Durban were the beginning of the end of the dualistic, race-based philosophy of the South African labour law.[19]

The Black Labour Relations Act did not have the desired effect. The economy still foundered and the country urgently needed an increase in foreign investments. In this situation the government appointed the Wiehahn Commission. This Commission under the chairmanship of Professor *Nic Wiehahn* was tasked to find ways to deal with the unsatisfactory situation that the South African

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[16] At this stage the Act was called Bantu Labour (Settlement of Disputes) Act.

[17] Thompson C, Twenty-five years after Wiehahn – A story of the unexpected and the not quite intended (2004) *ILJ* iii, iv; *Wiehahn* called it naive to deny this international pressure (Wiehahn, *The Complete Wiehahn Report,* 4.).

[18] 60.000 people were involved in these strikes (Source: Institute of Industrial Education, *The Durban Strikes 1973,* 52); Hetzel P, *Das kollektive Arbeitsrecht der Republik Südafrika*, 9.

[19] Numerous strikers and other employees became members of working class unions. Though these unions can not be considered trade unions, they were the forerunners of the Independent trade unions. After a while the working class unions took over the role of "real" trade unions. - Maree J, *The independent trade unions*, 2.

That is why the government reacted and passed the Black Labour Relations Act of 1973 [Bantu Labour (Settlement of Disputes) Act], which allowed the black workers to communicate with their employers through a liaison committee. Most of these committees were established by the initiative of the employers and so the unions recommended that their members not join these committees. The unions were anxious that such committees could undermine their own power and influence. - Bendix S, *Industrial relations in the new South Africa* (1996), 93.

economy found itself in, as well as the unsatisfactory labour legislation. The Commission had to satisfy different interests. Firstly it had to demonstrate to the international community that a kind of democratisation within the South African labour law was taking place as well as to show foreign investors that their investments would be protected. Also, it had to show that they would be able to "justify" their investments in apartheid exploitation by having several developments and reforms in favour of the non-white workers.[20] Because of the different interests within South Africa, the solutions of the Commission had to address the claims of the trade unions, on one side. On the other side, the racial system of the society had to be sustained.[21] According to *Öztürk*, the aim of the Commission was not to initiate a change of the racial system within the South African society, but to protect employers and the economy from unregistered black unions.[22] However, the establishment of the Commission started a development that led to the first democratic elections in 1994.[23]

The interim report of the Commission was tabled in Parliament on the 1st of May 1979. It captured and promoted the virtues of certain international concepts, e.g. the right to work, to associate, to bargain collectively or to withhold labour.[24] The suggestions of the Commission were to avoid racialism in labour legislation, to set up an industrial court to resolve disputes in respect of unfair labour practices and to recognize freedom of association as a principle. The recommendations to grant full freedom of association and to allow the registration of trade unions without any restrictions such as colour or race amounted to one of the most fundamental changes within South African labour law – the change from a dualistic, race-based and non-democratically structured system to a democratic and fully pluralistic system.[25]

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[20] ANC, *Non-Racial Trade Unionism in Historical Perspective*, 92 at http://www.anc.org.za/ancdocs/history/congress/sactu/wff2.htm.

[21] ANC, *Non-Racial Trade Unionism in Historical Perspective*, 60.

[22] Öztürk I, *German and South African Strike Law* 14.

[23] Nel *et al*, *South African Employment Relations*, 77

[24] Thompson C, Twenty-five years after Wiehahn – A story of the unexpected and the not quite intended (2004) *ILJ* iii, iii.

[25] Commissioner Nieuwoudt argued that black workers should not be prohibited from joining trade unions. He expected that activities of black trade unions would extend beyond labour matters and were bound to spill over into the political and social spheres, leading to untenable pressures - Nieuwoudt in Wiehahn, NE, *The Complete Wiehahn Report*, 37.

The most important change regarding labour relations in South Africa was that *all* workers could be defined under the term "employee" and that *all* workers had freedom of association. In addition, section 77 LRA (1956), which was the often-criticised safeguard against inter-racial competition and reserved special work for a special class of workers,[26] was abolished.

Prior to the 1988 amendments to the LRA (1956) South African labour law also did not have an express statutory basis for the doctrine of unfair dismissal.[27] The definition of an "unfair labour practice" as stipulated in section 1 LRA (1956) was wide enough to embrace the employees' interests in job security. It was decided by the Cape Provincial Division in *Towels, Edgar Jacobs Ltd v The President of the Industrial Court & others*[28] that the jurisdiction of the Industrial Court could constitutes an unfair labour practice resulting from an unfair dismissal. But the critics of this outcome called the competence of the Industrial Court regarding dismissal matters into question. The Industrial Court distinguished between substantive and procedural fairness of dismissal.[29] The dismissal had to be effected in accordance with a fair reason and a fair procedure. The Industrial Court decided in *Ntuli v Litemaster Products*[30] that a dismissal had to have "good and sufficient cause". Additional to valid cause, it was important that the employer followed a fair procedure prior to the dismissal.

As a result of the Wiehahn commission and its recommendations to establish a specialist Industrial Court, fair labour practices assumed centre stage[31] in South African labour jurisprudence. Because of the statutory gaps, this fairness had to cover the right to work, to associate, to bargain collectively, to withhold labour, to have protection and to receive training or to develop skills. This protection will be examined *infra.* It would be more than a decade before "fairness" in labour practices became a constitutional right. The South African law still did not provide any measures in the event of a transfer of an undertaking within its statutory law explicitly. Nevertheless, the implementation of the term "fairness" was obviously a first and significant step toward a philosophy of employees' protection in such circumstances.

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[26] Section 77 (6) (a) LRA 1956.

[27] Cameron E *et al*, *The New Labour Relations Act – the law after the 1988 amendments*, 107.

[28] In *ILJ* 1986, 496, 496 (E), 498 B (applicant's attorney).

[29] See *NAAWU v Pretoria Precision Castings* (IC) in *ILJ* 1985, 369.

[30] (IC) in *ILJ* 1985, 508, 518.

[31] Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 923, 923.

1.2) South African Insolvency Law prior to 1995

1.2.1) History of South African Insolvency Law

The dissertation's aim to examine of the law of transfer of insolvent undertakings makes it necessary to examine the labour law as well as the insolvency law concerned. In this regard, one must keep in mind that insolvency law and labour law have traditionally, but not necessarily, different objectives. The reasons for several problems regarding the employment matters in insolvency circumstances have their roots already in the early developments of the South African insolvency law. That is why a summary of the history of the law of insolvency as well as its status prior to the changes of the South African policy of the last few decades is important.

Compared to other countries, the South African insolvency law has seen very little of their extensive developments.[32] The reason for this as well as for the absence of a regulation regarding a transfer of employment contracts in cases of insolvency and the ignorance of the employees' interests can be found in the early roots of South African insolvency law as will be examined *infra.*

Despite the importance of English law, the roots of the South African insolvency law are found in Roman law. That is why the first roots of a possible protection of the employees could probably be found in *Table III of the Twelve Tables.*[33] This regulation did not offer any rights for the people who were employed by the debtor. The protected person was the creditor.[34] Neither the debtor nor his workforce was protected in cases of insolvency.

Roman-Dutch law introduced the *cession bonorum* principle at the end of the 15th century.[35] A court confirmed the *cessio bonorum* and appointed a trustee. The appointed trustee had the task of selling the property of the debtor at a public auction and distributing the profit of the auction to and among the creditors on a *pro rata* basis. In 1777 an ordinance was passed in Amsterdam that could be seen as the foundation of South African insolvency law.[36]

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[32] Boraine A & Van der Linde K, The draft Insolvency Bill – an Exploration (1998) *TSAR* 621, 621.

[33] Smith C & Sharrock RD, *Insolvency* in Joubert WA, *The Law of South Africa*, 90.

[34] As a consequence of failure of the described proceedings, the creditor had the right to kill his debtor or to send him into slavery.

[35] Smith C & Sharrock RD, *Insolvency* in Joubert WA, *The Law of South Africa,* 91.

[36] Smith C & Sharrock RD, *Insolvency* in Joubert WA, *The Law of South Africa,* 91.

Until 1803, when the *Desolate Boedelkamer* for the administration of insolvent estates was established, this proceeding remained the only lawfully applicable one in South Africa. The intention of the trustees' administration was to satisfy the creditors. It was not the intention to give the debtor a chance to act further in his business. The idea of a "fresh start" after the insolvency was not part of the principles of the South African insolvency law. As a result of its Roman roots, the insolvency law of the South African Union was advantageous for creditors, but not for the rescue of the insolvent undertaking or the preservation of employment.

1.2.2) The Insolvency Act 24 of 1936

The main principle of the Insolvency Act 24 of 1936 was that the creditor's claims had to be satisfied by the process of execution against assets. But as already mentioned, the aim of South African insolvency law was to protect the creditors of the debtor, not the debtor himself or herself. The current idea of a "fresh start" for the debtor or a philosophy of rescuing the business was not part of the insolvency law.

The statutory protection of employees in cases of insolvency of their employer dates back to the 19th century.[37] If one keeps the protection of employees' interests and the social views of the late 20th century in mind, one has to acknowledge that the protection afforded in the late 19th century remained limited. Due to the lack of a good social security system in South Africa as well as in numerous other countries, one will see the unenviable position of the employees.

First, one must acknowledge that the insolvency proceedings in regard to private persons formed the basis for the administration of all insolvency matters within South African insolvency law. The reason for this was the condition that the judicial construction of a legal person, which is separate from its members, was first developed in the late 19th century. Until that time the common law made provision only for individuals.[38] Except for the statutorily created legal persons, such as companies or close corporations, one could nevertheless see parallel developments.

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[37] Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1318 footnote 144.

[38] An exception to this is the Partnership, which was already known.

It is questionable, under which circumstances the provisions of the Insolvency Act are applicable. According to *Venter v Volkskas Ltd,*[39] the debtor is insolvent if his liabilities exceed his assets. This is known as actual insolvency. The situation is at first glance unclear where the person who is unable to pay his debts is not a natural but a legal person, i.e. a company or a close corporation. Because of the lack of a regulation regarding such cases in the Insolvency Act, one has to take a look at the special acts regulating matters for these legal persons. But even these acts did not provide any regulations in consequences of insolvency for the employment contracts. Neither the Companies Act 61 of 1973 nor the Close Corporations Act 69 of 1984 stipulated anything in regard to the employees' position in cases of the liquidation or winding-up of the company or close corporation.[40] The silence of these acts prompted the very important question as to, whether the contracts of services shall be terminated in cases of the liquidation of the legal person. This gap was closed by an adequate application of the regulations of the Insolvency Act. In cases of insolvency of the company or close corporation, regarding the regulations of the Insolvency Act and the common law, section 38 of the Insolvency Act was thus applicable *mutatis mutandis*.[41] In this regard section 339 of the Companies Act[42] stipulates,

> "In the winding-up of a company unable to pay its debts the provisions of the law relating to insolvency shall, in so far as they are applicable, be applied mutatis mutandis in respect of any matter not specially provided for by this Act."

In cases where the company or close corporation was wound up due to their inability to pay their debts, section 38 of the Insolvency Act was applicable. Though section 2 of the Insolvency Act stated that only the estate of a debtor could be sequestrated, section 38 Insolvency Act also operated in these cases.[43] The result of this application was that in cases of liquidation of companies one had to adhere to section 339 of the Companies Act 61 of 1973 and section 66 (1) of the Close Corporations Act 69 of 1984 in conjunction with section 339 of the Companies Act.

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[39] SA 1973 (3), 175, 179.

[40] Liversage A, 'n Ondersoek na die Toepassing van artikel 38 van die Insolvensiewet 24 van 1936 (1995) in *SA Merc LJ* 149, 152.

[41] E.g. Liversage A, 'n Ondersoek na die Toepassing van artikel 38 van die Insolvensiewet 24 van 1936 (1995) in *SA Merc LJ* 149, 152.

[42] 61 of 1973.

[43] Lombard S & Boraine A, Insolvency and Employees: an overview of statutory provisions (1999) *De Jure* 300, 301; Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1319.

In matters of the transfer of an insolvent company the distinction between voluntary winding-up and winding up by order of court played an important role. Regarding the first possibility, one had to differentiate between the voluntary winding-up by the companies' members and the creditors of the company. The voluntary winding-up by members took place when a company was able to pay its debts, whereas the voluntary winding-up by the companies' creditors took place in circumstances in which the company was insolvent.

The important date regarding the administration of the insolvent estate is the so-called "effective date".[44] The effective date is the date of the provisional sequestration order in the case of compulsory sequestration and the date of the sequestration order in the case of voluntary surrender. In cases where the company or close corporation would be wound-up by order of the court, the date of the application would be the effective date. If the winding-up does not occur by order of a court but voluntarily, the effective date is the date of registration of the special resolution.[45] The effective date is of great importance for the administration of the insolvent estate or legal person and the rights and duties of the person concerned. Even the rights of a trustee to act depend in certain matters on this date. This had consequences for the execution or the running up of the business as well as for the employment contracts.[46]

Sequestration order was and is a formal declaration that the debtor is insolvent. The debtor himself can apply to court for a sequestration order or the debtor's agents can apply to court to sequestrate the debtor's estate. If the debtor or his representative uses the first possibility, he applies to the court for the acceptance of the surrender of his estate. That is why the first possibility is called "voluntary surrender". The debtor had to fulfil several formalities for the voluntary surrender. If the court was satisfied with the fulfilment of these formalities and if it noticed that the debtor's estate was insolvent, that he owned sufficient property to defray the cost of sequestration and that the sequestration would be to the advantage of the creditors, it could accept the surrender and make an order sequestrating the debtor's estate.[47]

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[44] For a detailed consideration of the effective date see Liversages A, 'n Ondersoek na die Toepassing van artikel 38 van die Insolvensiewet 24 van 1936 (1995) *SA Merc LJ* 46ff. and 144ff.

[45] Sections 348 and 352 Companies Act 61 of 1973 and section 66 of the Close Corporation Act 69 of 1984.

[46] One should again bear in mind that such a running up of the business as a going concern was not foreseen in the insolvency law until the amendment of 2002 as will be considered *infra.*

[47] See section 5 (1) Insolvency Act.

If a debtor did not fulfil his duties with the creditor, the latter could enforce his rights by having recourse to the courts and eventually cause the attachment and sale in execution of the debtor's assets. A creditor could apply for the compulsory sequestration of the debtors' estate. This compulsory sequestration had already existed during the times of Roman-Dutch law in a *concursus creditorum* and was the ultimate form of execution.[48] A court could grant an application for the sequestration of a debtor's estate, if it was satisfied that there was reason to believe that it would be to the advantage of the creditors as a group if his estate was sequestrated. The sequestration is was divided in two stages, i.e. the provisional and final sequestration. The provisional sequestration should give the creditor a speedy and simple remedy for preserving the debtor's estate and to enforce his claim during the preliminary stage.[49] After that stage and several intermediate steps, a case went before the court for a second time to grant or refuse a final sequestration order.[50] The distinction between the provisional and final trustee and the time between their appointments was – and remains – of great importance regarding the transfer of an insolvent business, i.e. the rights and duties of the concerned persons during that special period.

The main goal of the sequestration under the Insolvency Act 24 of 1936 was to provide for the liquidation of the estate and to secure a distribution amongst the creditors, if a distribution was possible.[51] The control over the debtor's estate vested in the Master of the High Court until a trustee was appointed. The election of the trustee took place at the first meeting of the creditors.[52] It was the trustee's task to fulfil the duties of the sequestration. His control over the estate enabled him to sell the assets and to distribute the proceeds among the creditors. This was, according to *Mears v Rissik, Mackenzie & Mears' Trustee,*[53] in the interest of the insolvent because this proceeding offered the possibility to bring as many assets as possible into the estate and to reduce the debts as much as possible. The trustee may wholly or partially continue the business of the insolvent only with the authorisation by the Master of the High Court.

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48 Smith C & Sharrock RD, *Insolvency* in Joubert WA, *The Law of South Africa*, 104.

49 *Provincial Building Society of SA v Du Bois* (W) in 1966 3 SA 76, 80.

50 Smith C & Sharrock RD, *Insolvency* in Joubert WA, *The Law of South Africa*, 118.

51 Smith C & Sharrock RD, *Insolvency* in Joubert WA, *The Law of South Africa*, 128.

52 Boraine A, *Insolvency* in Nagel CJ *et al*, *Business Law* (2000), 414.

53 1905 TS 303, 305.

After the second meeting with the creditors, the trustee had to sell all assets under his control. If the debtor was not actually insolvent, he was entitled - after the date of his rehabilitation[54] - to any residue available after the payment of all his debts.[55]

The purpose of the sequestration was to pay *all* concurrent creditors at least a dividend instead of satisfying only a few or one creditor.[56] There were in general two different opportunities foreseen to apply for the sequestration of the debtors' estate provided by the Insolvency Act. But the advantage for the creditors had to be proved with both voluntary surrender and compulsory sequestration. Neither in cases of voluntary surrender nor in cases of compulsory sequestration was the employee given any say.[57] When the undertaking owed wages to the employee, he was in the position of a creditor and thus had some information about the company's financial situation and could seek the compulsory winding-up according to sections 344 (f), 345 (1) of the Companies Act 61 of 1973. Amazingly enough, such a creditor had no right to be informed or consulted in respect of his position as employee. The Companies Act curtailed the rights of an employee to claim from a company in the process of winding up.[58]

1.2.3) Rescue Proceedings

The trustee in the case of a natural person, or liquidator in the case of a juristic person, may elect not to retain the services of an employee. In such a case the employee had a concurrent claim for damages against the insolvent estate.[59] In *Hillhouse v Stott; Freban Investments (Pty) Ltd. v Itzkin; Botha v Botha*[60] *Levenson J* referred to a survey of the Master of the Supreme Court, Pretoria. According to this survey, concurrent creditors received dividends in only 28,6 % of sequestration in 40,6 % of the evaluated cases creditors were required to pay contributions.[61] This shows clearly the weakness

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54 See section 124 of the Insolvency Act.

55 Boraine A, *Insolvency* in Nagel CJ *et al*, *Business Law* (2000), 404.

56 Boraine A, *Insolvency* in Nagel CJ *et al*, *Business Law* (2000), 394.

57 Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 543.

58 Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1319.

59 Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 939; Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1318.

60 (W) in 1990 (4) SA 580 ff..

61 (W) in 1990 (4) SA 580, 586; See also Boraine A & Roestoff M, Vriendskapelike sekwestrasies - `n produk van verouderde beginsels? (1993) *De Jure* 229, 239 were the authors also refer to this survey– Werkstuk 29 Projek 63 "Review of the Law of Insolvency" (1989).

of the concurrent creditors' position. The sequestration or winding-up was thus in most cases disadvantageous for employees. Instead of winding-up, an insolvent company could also continue to trade. It seemed implicit that it would be advantageous for the persons concerned if an insolvent undertaking could be saved and rescued. If one acknowledges that, according to common law, insolvency of the business constitutes a breach of the contract and that according to section 38 Insolvency Act the winding-up leads to the termination of the employment contracts, one will see the unsatisfactory consequences for the employees when they lose their jobs and their livelihood. In cases of a continuing of the business, the employees would also have the chance to continue working.

For the rescue of a company, the Company Act has two different mechanisms: judicial management and the schemes of arrangements or compromises as provided in section 311 of the Companies Act.[62]

According to section 427 of the Companies Act, judicial management has the aim to enable the company, suffering a temporary setback due to mismanagement or other special circumstances,[63] to overcome its difficulties and to become successful again. After the appointment of this special rescue proceeding by the court, the business continues under the supervision of the Master of the Supreme Court. From the term "reasonable probability" of section 427 of the Companies Act one can conclude that this measure is not granted lightly. Judicial management is an extraordinary instrument of South African company law. One has to assume that judicial management in terms of the Companies Act is rare and not very successful in South Africa.[64] This mechanism is not granted lightly and its success rate is very low[65]. In judicial management cases, no priority is given to employee claims that arose prior to this management.[66] Due to the fact that judicial management did not affect the company's contracts, the employment contracts also remained unaffected. But because of the low success rate, judicial management entailed great risks for the employees.[67]

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[62] See also the references in section 197 (1)(b) LRA (1995) and section 197A (1)(b) LRA (2002).

[63] Cilliers HS *et al*, *Corporate Law* (1992), 475.

[64] Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 559.

[65] Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1323.

[66] Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1325.

[67] Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 560.

According to section 311 of the Companies Act, the company is also empowered to enter into a compromise or arrangement with its creditors. The court has to sanction the arrangement, which has to be agreed by three-fourths of the creditors or class of creditors. There are some different options for such agreements possible. On the one hand, the business can continue with the same or with new shareholders. On the other hand, the business can be sold to a new owner.

A great disadvantage regarding the employee interests was the fact that such schemes often led to a loss of employment. This also occurred where the legal person set aside winding-up. Even in circumstances where the undertaking was sold, the employees were not entitled to remain employed.[68]If the undertaking continued to carry on its business, the employees continued with their employment undisturbed, unless their undertaking dismissed them for bona fide operational requirements. In this situation ordinary principles of law regarding unfair dismissals would be applicable and the employees would, for example, be entitled to severance pay. This position becomes more complicated if the scheme has been entered into after a winding-up order has been granted. The deciding court would usually make an order staying or setting aside the winding-up on such terms and conditions as it may deem fit.[69]

The outcome for the employment contracts in such circumstances is debatable. According to *Smit,* there is no settled law whether the effect of such an order is to revive automatically any employment contracts that were terminated in terms of section 38 of the Insolvency Act upon the commencement of the winding-up proceedings.[70] *Blackman* argued in favour of the automatic revival of employment contracts. Furthermore, according to Blackman, a company could be enabled to use winding-up as a weapon against its own employees or their union. Blackman shows that an order staying a winding-up automatically reinvests the directors within their office and from this he concludes that all employment contracts terminated by the winding-up are automatically revived – just as if there had been no winding-up.[71]

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[68] Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1325.

[69] According to Section 354 (1) of the Companies Act.

[70] Smit N, *Labour Law implications of the transfer of an undertaking*, 383.

[71] This is only possible if the Court did not make an order on the contrary.

The second scenario involves the sale of an undertaking. Where an agreement to transfer is a term of a scheme of arrangement or compromise, employees are not afforded rights to consultation or disclosure in terms of either company or insolvency law. However, labour law does assist employees in this regard to a certain extent, especially where there is a workplace forum in the undertaking that is being transferred. The employment contract as well as the rights and duties of both sides of this contract and the rights of the representatives of the employees determine these consequences, which will be examined *infra*.

1.2.4) Conclusion

Knowledge of the developments and basic principles of South African insolvency law is necessary to ascertain the intention of the legislature and jurisprudence during the past decade. Under the influence of section 38 of the Insolvency Act, employees did not have any say in the sequestration of the estate or the liquidation of the legal person they had worked for. Only in cases where they had the status of creditors did they have some knowledge about the financial status of the employer. If this was not the case, they did not have the right to be informed or consulted.[72] The insolvency law as stipulated by the Insolvency Act provided in favour of the creditors and placed the employees in an insecure and insufficient condition. Because insolvency caused a termination of employment contracts, the payment of claims posed legal difficulties if the employee continued working after the winding-up of his employer. The lack of disclosure of information and the fact that employees had no say in these matters and was also disadvantageous for the employees. However, in most cases the employees had a status as creditor because of due wages. This position gave them the possibility to be informed about the undertaking's current situation.

The Insolvency Act tried to provide creditors a chance to get the highest possible dividend by liquidation and sequestration. It was not the aim to provide job security or to offer rescue proceedings. A philosophy that would have lead to the rescue of an insolvent undertaking was not established in South African law yet.

[72] Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 543.

1.3) The Transfer of Undertakings prior to 1995

1.3.1) The contract of employment

If one attempts to examine the above-mentioned theoretical possibilities in cases, where an insolvent undertaking will be transferred from one person to another person, one must consider the different interests of the persons concerned within these circumstances.[73]

In circumstances where an insolvent undertaking could be transferred, insolvency, company and labour law matters entered the picture. The interaction between insolvency principles and employees' rights raised difficult problems.[74] The main question that will be considered within this chapter was the outcome of the employment contract in such circumstances. There were several possibilities to manage this situation. On the one hand, there is the extreme measure of automatically terminating all employment contracts with the old employer. On the other hand, there is an automatic transfer of all contracts to the new employer, i.e. the substitution of the transferor by the transferee without any exceptions. The first possibility is similar to the US model of employment on an at-will basis. The model, in which the employment contract would be transferred automatically, is closer to the principles behind the Acquired Rights Directive of the EEC.[75] This possibility has been used in Germany since the early 1970s, because § 613a BGB came into effect in 1972.[76] During the discussions of the Wiehahn commission the right of the employees to get their employment contracts transferred to the transferee was already known. Despite the opportunity to adapt foreign law to South African law, one had to consider the special needs of the South African economy, as well as the development and roots of the South African law.

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[73] In the whole dissertation the transfer of the employment contract does not refer to the transfer of the employee, as it is a moving of the employee to another section within the same organisation or to another branch of the same organisation.

[74] Smit N, *Labour Law implications of the transfer of an undertaking*, 372.

[75] The Directive of the Council 2001/23/EC (the ARD) replaced the Directive 77/178/EEC, as amended by Directive 98/50/EEC, on 12th of March 2001.

[76] The European and German provisions will be examined *infra*.

1.3.1.1) The fundamental power to transfer rights and duties

To consider the special problems with the contract of employment in transfer matters, one has to pay attention to the general principles of the transfer of rights, duties or a whole contract in terms of South African law prior to 1994. Although there were several gaps within the statutory provisions during these decades, one could find the general principles regarding the transfer of rights and duties in South African common law. For the transfer of rights and duties, several models were possible. The two main possibilities were the cession and delegation of rights or duties, and the novation of the contract.

In general, a cession and delegation of rights and duties was and is possible under common law. In civil law a cession and delegation means an assignment by which the rights and duties of a contract will be transferred to a third party. The transferee's party will replace the original party, which will hold the duties and rights according to the agreement. The transferee will thus substitute the transferor by the act of cession in respect to his rights. The substitution regarding the transferor's duties needs a delegation of these duties.

The common law offers the opportunity to transfer not only certain rights and duties, but also a whole contract. Such a transfer of contract could be constructed as a novation.[77] The term novation has its origins in Roman civil law. In a novation an already existing contract can be substituted by some new contract, either between the same parties or between different parties. Especially the latter could be of great importance in transfer of undertaking's matters, if a party enters the picture that was not a party to the original duty. Novation necessitates an agreement of all concerned parties, especially where one party substitutes another party.

Beside the possibilities to transfer rights, duties or even the contract as a whole, South African common law also acknowledges a transfer of a contract by operation of law, the so-called *huur gaat voor koop* principle.[78] This principle is illustrated by the effect of a sale of property which is leased by the time of the sale.

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[77] Christie RH, *The Law of Contract in South Africa* (1991), 559; The novation of an existing contract is also possible under the German law too, see Palandt-Heinrichs, *Kommentar zum BGB* §§ 364, 365 who describe the novation as a "Schuldumschaffung".

[78] See for instance *Standard Bank of South Africa v. Prinsloo and Another* (CPD) in 2000 (3) SA 576 or the Supreme Court decision of *SA Breweries Ltd. v. Pieter van Zyl*, where the court discussed the question whether this principle shall be applicable in labour law cases (381/04).

The buyer or a third party would automatically become a party to the leasing contract. In other words, the lease contract will automatically continue between tenant and buyer, who will now become the lessor, even though the buyer does not agree to this. In this instance, protection of the tenant overrides the buyers' right to his own property.

1.3.1.2) The power to transfer an employment contract

It was unclear whether the above-mentioned possibilities were applicable within the employment environment.[79] It was especially questionable whether the transfer of the duties of the employee by delegation without the consent of the new employer was possible. In cases of novation it was required that all three parties consent to this transfer.[80] There could not be a difference between an "ordinary" contract and a "personal" employment contract. In other cases the courts had to answer the question if employment contracts have such a personal character that the consent of all concerned parties was necessary.[81] An examination of the legal character of the contract of employment between employer and employee was of great importance and will be discussed *infra*.

The common law provided for a general right to the creditor to transfer his rights against the debtor by way of cession without the consent of the debtor.[82] The freedom to transfer personal rights and duties could nevertheless be limited.

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[79] Prior to the implementation of § 613a BGB in 1972, the possibility of transferring a contract of employment or even single rights and duties of such a contract was very limited under German law. According to Nikisch, a transfer of employment contracts by operation of law was the best possible solution to resolve the above-mentioned problems. (Nikisch, Arbeitsrecht I, 659) According to one opinion a transfer of employment contracts could happened as a private transaction, but also as a transfer by act of law. In the last-mentioned case the consent of the parties concerned would not be necessary. (Annuß/Richardi in Staudinger-Kommentar zum BGB, § 613a BGB no. 3; Nikisch, Arbeitsrecht I, 660) According to this opinion, the transferee should enter into the rights and obligations of the contract of employment in analogy to § 571 BGB (old version). These section resembled the South African common law principle *huur gaat voor koopt*. But according to the leading opinion the consent of all affected parties was necessary for contracts of this nature. The transfer of an employment contract was an ordinary tripartite contract. A transfer in the same way as a private transaction was thus possible. But no statutory regulation facilitated the transfer and provided for a transfer of employment contracts by act of law. The precedents of the Federal Labour Court (BAG) (E.g. BAGE 2, 127; BAGE 13, 333, 338) and the majority of authors (Hueck A/Nipperdey HC I 516; Müller-Glöge R in Münchener Kommentar zum BGB, § 613a at no. 1; Raab T in Soergel - Kommentar zum BGB, § 613a at no. 12.) urged the consent of the concerned parties. A transfer of contracts against the will of the employees as well as against the will of the concerned transferor and transferee was regarded as undesirable.

[80] Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 937.

[81] Selwyn N, *Law of Employment* (2004), 230; Smit N, *Labour Law implications of the transfer of an undertaking*, 13.

[82] Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 936; Blackie W & Horwitz F,

The impossibility to transfer rights and duties resulting from the contract by an ordinary cession and delegation could be, on the one hand, based on the concept of privity of the employment contract in the common law,[83] and, on the other hand, on the special nature of employment contracts. The special and personal nature of the employment contract was also called into question by several courts, lawyers and academic writers. They doubted that it mattered to whom the employee gave his loyalty, pledge to serve, and good faith.[84] However, the Industrial Court held that it is a misunderstanding that an employee would not attach importance to the identity of his employer.[85]

The English Appeal Court, in persona Lord Atkin, stated in its well-known decision of *Nokes v Doncaster Amalgamated Collieries Ltd*,

> "I had fancied that ingrained in the personal status of a citizen under our laws was the right to choose for himself whom he would serve: and that right of choice constituted the main difference between a servant and a serf."[86]

The court further argued in respect to the possible transferee,

> "It is said that one company does not differ from another: and why should not a benevolent judge of the Chancery Division transfer the services of a workman to another admirable employer as good and perhaps better. The answer is two-fold. The first is that however excellent the new master may be, it is hitherto the servant who has the choosing of him, and not the judge. The second is that it is a complete mistake in my experience to suppose that people, whether they are servants or landlords or authors, do not attach importance to the identity of the particular company with which they deal."

The reason for the employee's right to decide for himself can be found in the principle of freedom of choice in the common law and so Viscount Simon (L.C.) argued in the same case,

> "It will be readily conceded that the result contended for by the respondents in this case would be at complex variance with a fundamental principle of our common law, the principle, namely, that a free citizen, in the exercise of his freedom, is entitled to choose the employer whom he promises to serve, so that the right to his services cannot be transferred from one employer to another without his assent."[87]

Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1388; Smit N, *Labour Law implications of the transfer of an undertaking*, 13.

[83] Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1387.

[84] Smit N, *Labour Law implications of the transfer of an undertaking*, 14.

[85] E.g. in *Ntuli v Hazelmore* (IC) in *ILJ* 1988, 709 ff. and *Numsa v Metkor Industries* (IC) in *ILJ* 1990, 1116 ff..

[86] 1940 AC 1014, 1026.

[87] 1940 AC 1014, 1020.

The employee's freedom to choose whom he wanted to serve was aligned with the law of cession. A creditor was generally free to transfer rights against a debtor by way of a cession without the latter's consent, but he did not have this freedom in cases where personal contracts such as employment contracts were involved.[88]

On the other hand, the English court denied in *Nokes* that the employee had the right to continue his employment and allowed the transferee to employ a new workforce. The result of this view was obviously that the employees would suffer a lack of job security. It is questionable whether the employee values the freedom to decide for which employer he wants to work, when the employer's business or part thereof is transferred. Especially in labour markets with high unemployment it is possible that the freedom to choose is not as important as job security.

An extension of the freedom to choose could lead to a situation whereby, in cases where a change in the effective ownership of a business occurs,[89] such a disposal should be treated as bringing contracts of employment to an end, attracting a liability to provide severance pay and affording the employees a choice as to whether they wished to be employed by the new employer or the corporate vehicle under new ownership.

These conflicting interests led to disputes between the employers' interest to safeguard sensitive information and the employees' interest to be informed at the earliest possible time to make decisions about their employment future. Regarding the new employer and purchaser of the undertaking, one must keep in mind that a continuity of the work within the undertaking was rather possible, if the work force stayed with the business and fulfilled their contractual duties in the same way as for the former employer. In such cases it would be an advantage for the purchaser if the legislature had offered an automatic mechanism for the transfer of the contracts. But in numerous cases the purchaser of the undertaking would have a stronger interest and even need to decide with whom he wants to continue working after the transfer.

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[88] Smit N, *Labour Law implications of the transfer of an undertaking*, 98.

[89] Whether by the disposal of the business or by the disposal of the shares of the company – Wallis MJD, Section 197 is the Medium. What is the Message? (2000) *ILJ* 1, 2.

Some contract law and labour law authors argued in favour of the necessity to consent to a transfer by cession and delegation as a form of novation.[90] The sale of a business under the common law meant the termination of the contracts of employment and granted the opportunity to the purchaser to decide whether he wanted to offer the workers concerned re-employment or not.[91] This view corresponded with the employers' freedom of contract. In cases of the sale of a business, the purchaser had the right to choose his employees and the employee had the right to decide whether or not he wanted to work for the purchaser. The reason for these rights could be found within the freedom of contract of the affected persons, especially the employee's freedom to decide for whom he wanted to work. In times of high unemployment the employee will not only have an interest in the person he is working for, but also, and certainly foremost, an interest to preserve his employment. As *Jordaan* wrote, the heart of the disputes over transfers lies in the clash between the employers' interest in the economic efficiency and the survival of the undertaking and the employees' interests in job security.[92] The interest in job security was already confirmed in cases where the change of ownership was effected by a change of the ownership of the shares in the company that owned the business.[93] In such circumstances, the employment contract followed the business.

1.3.2) The protection of employees in South Africa

The employees' freedom of contract could have a disadvantageous effect for the employees. Due to the fact that the transferee was under no obligation to offer the employee of the transferred undertaking any employment, the employee could lose his livelihood. It is questionable, whether there was a legal stipulation to protect ordinary workers from termination of their contracts of employment. In this regard, one has to acknowledge the interest of the majority of employees, not to lose their jobs due to the transfer of the undertaking. In cases where no offer to employ was forthcoming, the employees had only the right to file a claim against the transferor. When the former employer was insolvent, these possibilities to file claims were useless. In each case one has to examine whether employees' interests are being protected during the transfer of "their" undertaking.

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[90] Christie RH, *The Law of Contract in South Africa* (1991), 559; Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 937.

[91] Du Toit D *et al*, *Labour Relations Law: A Comprehensive Guide,* 397.

[92] Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 935.

[93] Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 3; Driver G, Commercial Perspective on section 197 of the Labour Relations Act (2000) *ILJ* 9, 13.

1.3.2.1) Protection of employees by statutory law

Statutory law prevails over the common law regulations if it specifically repeals the common law. If there is statutory law, it will be the basis for the judicial decisions. That is why one has to consider the protection of the employees in transfer circumstances in the applicable statutes. But despite the lack of employees' protection by the Constitution, even the LRA (1956) did not provide any measures for the transfer of an undertaking neither as a going concern nor in other circumstances.

Prior to the implementation of section 197 LRA (1995) in 1996, ordinary statutory law did not fundamentally regulate the effect of the transfer of a business to the contract of employment.[94] The legislator regulated this only in a few cases. Only two statutes provided a limited continuity of employment.

The Manpower Training Act[95] stipulated in section 22 (5)(a)

> "if any person is apprenticed to a partnership, his contract of apprenticeship shall not be terminated by reason of the death or retirement of any partner if the business of the partnership is continued by another person or partnership, but the rights and obligations of the employer under the contract shall in such case be deemed to be transferred to the person or partnership continuing the business."

The Basic Conditions of Employment Act[96] provided in section 12 for employees' rights to annual leave. It its subsection (7) this Act stipulated the meaning of the term "employer"

> "In this section "employer" includes-
> (a) in the case of the death of an employer, the executor of his estate; or
> (b) in the case of the insolvency of an employer or the liquidation of his estate or the transfer of his business, the trustee or liquidator or the new owner of the business,
> if such executor, trustee, liquidator or new owner continues to employ that employee."

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[94] Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 11.

[95] 56 of 1981.

[96] 3 of 1983, hereinafter the BCEA.

Both Acts came into effect as a result of the numerous changes in South African labour law after the recommendations of the Wiehahn Commission. Especially section 12 (7)(*b*) of the BCEA seems to provide for the transfer of certain rights and obligations. On one side, one has to bear in mind that this transfer by act of law did only happen in the limited sense of section 12 of the BCEA, i.e. from the insolvent old employer to a new employer. On the other side, the last words of this subsection, "if such … new owner continues to employ that employee", make it clear that this section was in accordance with the common law. That means that the consent of the people concerned was necessary in cases of the transfer of the contract of service. According to the text, it seems that this subsection did not provide for a transfer of employment by act of law. It was thus only a special statutory outflow of the above-mentioned common law stipulation.

The statutory labour law of South Africa did not provide a general statutory protection of the employees in the transfer of an undertaking.[97] Special social points of view were not of great importance. Social rights and standpoints were still overruled by the common law principle of freedom of contract.

In 1979 the Industrial Conciliation Amendment Act was enacted upon the government's acceptance of the Wiehahn Commission report. The Industrial Conciliation Amendment Act introduced the term "unfair labour practice" and defined it as "any labour practice, which in the opinion of the Industrial Court is an unfair labour practice". With this peculiar formulation the legislator attempts to define the important fair labour practices principle. In the opinion of many observers, this obvious loophole may be the means by which the racial division of labour may be maintained in certain industries, notwithstanding the official elimination of statutory job reservation.[98] The minister had the power to order the cessation of an "unfair labour practice" until the time when the dispute over such a practice was settled by an industrial council, conciliation board or the Industrial Court itself.[99] Despite strong criticism by the ANC, it is to recognize that the question of unfair labour practices needs an examination of every single case and a valued decision by the courts. A definition by the legislator would be problematic if not impossible. However, the legislator could have set some grounds for the courts, which it failed to give.

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[97] Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 939.

[98] ANC, *Non-Racial Trade Unionism in Historical Perspective*, 88.

[99] ANC, *Non-Racial Trade Unionism in Historical Perspective*, 88.

1.3.2.2)Protection of employees by common law regulations

The need for the employees' consent for the transfer of an employment contract was expressed in the decision of the case *Ntuli & others v Hazelmore Group t/a Musgrave Nursing Home*[100]. The Industrial Court held that, in terms of South African common law, it was clear that the transferor of an undertaking cannot transfer his or her obligations under a contract of service to the transferee of the undertaking without the consent of the employee concerned.[101]

As stated *supra*, the common law principles led to a situation whereby employees had the freedom to decide for which employer they want to work. The other side of the coin was the problem that, in circumstances where the undertaking was transferred, the transferor usually terminated the employment contracts. The transferee had the right to choose whether he wanted to continue working with the old work force or not. The disadvantage behind the principle of freedom of contract was that this principle could work against the employee. When he did not receive an offer to work for the transferee, he had only the possibility to claim against the former employer and transferor. The disadvantage of this solution becomes significant when one considers the situation for the employee when the transferor was insolvent. The protection for the employee in circumstances of insolvency,[102] as well as for the retrenched employee, was insignificant enough to lead to a complete loss of his employment and livelihood. Because of the lack of clear legislative provisions, it was especially the Industrial Court's task to protect employees from such losses. A balancing of the different interests of employees and employers needed an examination of the relationship between these parties.[103] An examination of the clashing interests and the legal character of these relationships was the basis of a best possible balancing out of these interests. For a judicial intervention of the Industrial Court, this relation had to be evaluated according to a specific reviewer's perception of justice. This made the identification and consideration of the most common models in these matters relevant.

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100 (IC) in *ILJ* 1988, 709 ff.

101 *Ntuli v Hazelmore Group* (IC) in *ILJ* 1988, 709, 713.

102 Smit N, *Labour Law implications of the transfer of an undertaking*, 97.

103 (IC) in *ILJ* 1980, 227, 246.

According to *Smit,*[104] there are, among numerous other possibilities around the world, four main models. These include the traditional contractual model, a contractual model added by public interests, the model whereby each party can advance its own interest to the extent that these interests are compatible with the other partner and, finally, the model where the employment contract ultimately concerns the wealth and welfare of the whole society.

The traditional contractual model is based on the assumption that both parties enter the agreement on equal footing. Employer and employees are for that reason equal partners. The employment contracts are thus private transactions resulting from free agreement between the affected parties. For that reason judicial intervention should be limited to preserving and enforcing the contractual agreement between the parties. The most common criticism in this regard is that the model takes "freedom of contract" as a social fact rather than a verbal symbol. Within this model of the employment relationship there would be no need for provisions that provided for job security or a transfer of the contract by act of law as stipulated in the Acquired Rights Directive of the EEC.

With respect to possible public interests, it is to ask whether the employment partners are really on equal footing. In times of high unemployment the employees could find themselves in a weaker position due to the lack of jobs and their fear of losing their current jobs. A regulation of the labour markets based on the relationship between supply and demand is, because of the lack of employment offers, not possible under such circumstances. Despite the recognition that the parties should be free to conclude employment contracts, the second model acknowledges a certain public interest, i.e. that the interests of the weaker party shall require attention and are worthy of protection. By establishing a so-called "floor of rights", the state would have fulfilled its role in ensuring that a disparity in bargaining power is addressed. This model could also be viewed as accepting the existence of moral claims of fair labour practices as with human rights. In this case, the state has the aim to enforce those moral rights. Regarding this model, one has to keep in mind that, especially in the transfer of an undertaking, a statutory "floor of rights" did not exist prior to the democratic developments of the 1990s. Neither the constitution nor other acts provided for such employees' rights in the same manner as after the democratisation.[105] It was the judiciary which considered the moral claim to fair labour practice.

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[104] Smit N, Should Transfer of Undertakings be statutory regulated in South Africa? (2003) *Stellenbosch LR* 205, 218; Smit N, *Labour Law implications of the transfer of an undertaking*, 20.

[105] As already stated *supra.*

According to a third model, employment contracts are not ordinary commercial contracts concerning an exchange of performances. That is why many contractual principles that have been developed for commercial contracts are inappropriate. The parties to the already existing employment contract as well as the transferee of a transferred business should therefore have a genuine concern for promoting the interests of the other affected parties. Even the freedom of contract could face several incursions as a result of the fact that the positions of employers and employees on the market are not necessarily equal. It is of course inevitable that such incursions are justifiable and appropriate. Each party can advance its own interests, but only to the extent that those interests are compatible with the other's interests.

The fourth model does not view the employment contract as a private contract, but as a transaction that ultimately concerns the wealth and welfare of society as a whole. In situations where the needs of the society conflict with any individual interests, the individual interests have to be overridden by the needs of the society.

The conflicting interests can be seen in circumstances where employers are negotiating to transfer a business. The managerial prerogative may want to keep certain records with reference to the employment relationship confidential, whereas society requires transparency and the disclosure of information, unless an acceptable justification for non-disclosure exists. Inconvenience and pure economic costs would not add enough weight to the argument that the individual need of an employer should prevail over the welfare of society as a whole.[106] Negotiations could fail due to the public's access to information and this could again lead to a disadvantageous situation for the affected stakeholders.

As stated in *NAAWU v Borg Warner SA (Pty) Ltd,*[107] the whole employment relationship is a much wider notion than that of the employment contract. If one acknowledges that in a capitalist society there are several possible situations where the labour market is not balanced fully, one has to pay attention to the weaker position of the employee. This attention will lead to a protection of the employee not to lose his livelihood and to be treated fairly. In every single case a substantive approach to equality and fairness is necessary and in most modern economic societies widely accepted.

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[106] The problem of disclosure of information (and consultation) will be considered in detail *infra.*

[107] (IC) in *ILJ* 1994, 509.

1.3.2.3)Protection of employees by the Industrial Court: The unfair labour practice principle

Although numerous problems will be examined *infra*, a summary of the judiciary protection of employees' rights is essential. Because of the lack of legislative and common law stipulations regarding the transfer of undertakings prior to 1995, employees' protection by the judiciary was of great importance.

Although the LRA (1956) did not provide for the transfer of employment contracts in circumstances where an insolvent business was transferred, the legal basis for the protection of the workforce by South African courts could be found within this act. The stipulations resulting from the LRA (1956) regarding unfair dismissals or unfair labour practices were the only statutory basis for the jurisdiction of the Industrial Court. Because of the lack of legislative measures South African courts considered the cases regarding the transfers of undertakings in the light of the fair labour practice principle.[108]

According to section 1 (1)(xlvii) of the LRA (1956), "unfair labour practice"

> "means any act or omission, other than a strike or lock-out, which has or may have effect that-
> (i) 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 jeopardized thereby;
> (ii) the business of any employer or class of employers is or may be unfairly affected or disrupted thereby;
> (iii) labour unrest is or may be created or promoted thereby;
> (iv) the labour relationship between employer and employee is or may be detrimentally affected thereby[.]"

The unfair labour practice jurisdiction of the Industrial Court was, according to *Smit,* characterized by the discretionary power of the court.[109] It began in 1980 with the decision to *Metal & Allied Workers' Union & another v A Mauchle (Pty) Ltd t/a Precision Tools,*[110] which is called the first "unfair labour practice" case.[111] In this jurisdiction, the Industrial Court tried to implement an element of

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[108] German courts considered the relationship between the employee and its labour or industrial organisation of great importance, especially before the implementation of the § 613a BGB into the German statutory law. According to this view, the special person of the employer is not of great importance. The relevance of the relationship of the employee within "his" workforce organisation was recognised in numerous countries abroad. The consequence of that recognition was the incorporation of regulations that acknowledge the interest of the employee to continue working within this workforce organisation.

[109] Smit N, *Labour Law implications of the transfer of an undertaking*, 32.

[110] (IC) in *ILJ* 1980, 227 ff..

[111] Cheadle H, The first "unfair labour practice" case (1980) *ILJ* 200, 201ff..

fairness and equality into the process.[112] This can be seen as a consequence of the philosophy that the law has to strengthen the position of the employees if one acknowledges that his position is weaker than the employers' position.[113] All decisions and other forms of conduct between the parties should, according to the results of the Wiehahn commission, be fair, equal, equitable and reasonable. In this regard *Cheadle* argued that the introduction of fairness was obviously a policy decision. Like other policy decisions, fairness also demanded pronouncement by the courts. Because of the lack of sociological investigation in this regard, it could be expected that the Industrial Court would rely on the fiction of prevailing values of fairness in the community. The main objective point was to balance the respective interests of the employer and the employee in a capitalist society.[114] In *Kebeni v Cementile Products Pty Ltd*[115] the Industrial Court referred to the reasonable expectations of employees and employers to balance their different interests.

According to *Le Roux,* the most important facet of this jurisdiction was the will of the Industrial Court to investigate the fairness of any dismissal that flows from a sale of assets.[116] The seller of the assets and former employer had to show the justifiable reasons for the dismissal as well as that the procedures regarding these dismissals prior to and during the retrenchment were fair.

The question whether there was a good reason for the dismissal was in most cases easy to answer. The sale of the assets leads to a lack of facilities for the employees to work. Because of the fact that there is either not enough or even any work for the employees, they can be of no service to the seller of the assets. That is why the reason for the retrenchment could be seen as the operational requirements of the business. In cases where the decision of the employer was bona fide and not motivated by factors such as anti-union sentiment, the Industrial Court had generally been reluctant to interfere with these decisions.[117] Besides the investigation of the good reason for the dismissal, the Industrial Court protected the rights of the employees by the introduction of procedural requirements, which the employer had to fulfil prior to the dismissal. The most important pre-transfer duty of the employer was the requirement of consultation, which will be considered *infra.*

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[112] Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

[113] A closer look to the relationship between employee and employer will be taken *infra.*

[114] Cheadle H, The first "unfair labour practice" case (1980) *ILJ* 200, 201.

[115] *Kebeni v Cementile Products Pty Ltd* (IC) in *ILJ* 1987, 442 ff..

[116] Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

[117] Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

In 1987 the Industrial Court recognised the urgent need for job protection in transfer matters. To protect employees from losing their jobs, the Industrial Court demanded fair retrenchment procedures. The court stated, in *Kebeni v Cementile Products (Ciskei) (Pty) Ltd,*[118] that safeguards should be incorporated into an agreement between the seller and the purchaser of the business to ensure that the interests of the work force are adequately protected. In *Kebeni,* the seller of the business closed down the undertaking and transferred the operations to another company, which relocated the undertaking to Ciskei. Though the court recognised that there were also financial reasons, it found poor labour relations in the company to be a contributing factor of the transfer. In this regard the court stated that the old employer failed to act in fairness and equity in the retrenchment of its employees. In this case the court also referred to the British TUPE (Transfer of Undertakings: Protection of Employment Regulations of 1981), where an automatic transfer of the contracts by act of law was provided for in circumstances where the business was sold as a going concern. In accordance with these provisions, the Industrial Court stated that the agreement of transfer of the assets of the old employer should incorporate a clause to safeguard the rights of the employee. All existing contracts of employment would be deemed to have been transferred to the new employer, who would be obliged to retain all existing employees without discrimination. An individual employee may have the option not to continue his employment relationship with the transferee.[119]

In the Industrial Court case of *Numsa v Metkor Industries (Pty)*[120] one can find a further example of the concept of fairness within the South African jurisdiction. One could say that any result flowing from a lawful act would also be lawful and fair.[121] Such an approach is possible only if one would apply the term 'lawful' to an extent that contained also the terms 'fairness' and 'equity'. However, the Industrial Court was not satisfied by this approach to the concept of fairness. Roth AM held in *Numsa v Metkor*[122] that a lawful act is not always necessarily fair and equitable. For fair labour practice, the results of the employer's actions have to be equitable and fair, not only lawful. It is thus to conclude that the results from the lawful sale of a business do not necessarily result in an automatic termination of the employment contracts. Even in circumstances of a lawful transfer of

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[118] (IC) in *ILJ* 1987, 442 ff..

[119] See also Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1391.

[120] (IC) in *ILJ* 1990, 1116-1127.

[121] See also at the attorneys' opinion in the case of *Numsa v Metkor Industries (Pty) Ltd* in *ILJ* 1990, 1116, 1118 F.

[122] (IC) in *ILJ* 1990, 1116 ff..

business, the retrenchment in this regard can be unfair.[123] This was also held in *Ntuli v Hazelmore Group.*[124] The South African courts evaluated the fairness of any retrenchments in circumstances where an undertaking is transferred by applying the following guidelines, e.g.

· Adequate notice and consultation of the employees prior to the proposed transfer or possible retrenchments;

· Attempts to reach an agreement between transferor and transferee in respect of the rights of employees;

· The lapse of a reasonable period of time after the transfer, resulting in continuity of service with a transferee;

· Full disclosure once a sale was concluded;

· The preservation of industrial peace; and

· The fairness of any subsequent termination of services.[125]

The Industrial Court utilised its unfair labour practice jurisdiction to require fair play towards employees in the context of transfers of undertakings.[126]

It is obvious that the decision as to what is fair and unfair is a value judgement. The mere wording of the LRA (1956) did not protect the employee's interests to such an extent. The jurisdiction of the Industrial Court was not only based on the provisions of the LRA (1956). It was furthermore made on the basis of the Industrial Court's sense of equitability and fairness, which drew extensively on the ideas of the International Labour Organisation and the jurisdiction and legislative actions of countries abroad.[127] Although numerous other countries provided for a transfer of employment contracts by act of law, the South African courts could not apply a statutory provision to allow a transfer of an employment contract by act of law. Despite knowledge of international jurisprudence, they were not willing to apply these principles to South African cases because of the principles of the common law as stated in *Ntuli v Hazelmore.*[128] Despite the lack of statutory provisions, one can attest that the South African courts had a fair measure of sympathy for employees faced with these circumstances.[129]

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123 *Numsa v Metkor Industries (Pty) Ltd* (IC) in *ILJ* 1990, 1116, 1120.

124 (IC) in *ILJ* 1988, 709, 720.

125 Smit N, *Labour Law implications of the transfer of an undertaking*, 108.

126 Smit N, *Labour Law implications of the transfer of an undertaking*, 108.

127 Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 923, 923.

128 (IC) in *ILJ* 1988, 709 ff..

129 Smit N, *Labour Law implications of the transfer of an undertaking*, 108.

The recognition of the importance of the relationship between the employee and the *undertaking* would lead to other results regarding the transfer of that undertaking than closer examination of the relationship between employee and *employer*.[130] The reason for this opinion was the distinction between the employment contract and the relationship created by that contract as already stated *supra*.

1.3.3) Transfers outside the application of these protections

There were some exceptions in transfer cases where the rights of employees were not protected. These exceptions were linked with the transfer of the shares of an undertaking and the mere transfer of assets.

At a transfer of shares the transferred undertaking does not change its legal personality, i.e. in most cases "transferor" and "transferee" remain the same legal person. The change of the shareholders thus does not lead to a change of the undertaking. No specific protections for transfer circumstances are applicable, because the employment relationship between the undertaking and its employees continues unaffected.[131] But such an approach does not cover the practical consequences of a transfer of shares. A "*big company can buy the majority of shares in the old company: replace the directors and managers: change the policy…*"[132] According to *Le Roux,* these new policies and procedures could in turn lead to changes to conditions of employment and even to retrenchments.[133] Although conditions of the employment contract cannot be changed unilaterally, the employees have to be protected from unfair treatment by the new controller of the business. Any measures by the employer, e.g. retrenchments, of course have to be in accordance with its legal obligations.[134] It is still questionable whether the lack of special protection can really lead to a fair balance between the affected persons.

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130 Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 953.

131 Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 11.

132 *Nokes v Doncaster* in 1940 AC 1014 CA.

133 Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 11; Smit N, *Labour Law implications of the transfer of an undertaking*, 119.

134 Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 11.

When an employer sells its factory premises and machinery to a purchaser, he loses the possibility to employ his workers because of the lack of working facilities. According to common law principles, the seller will have the opportunity to terminate the contracts with his workers.[135] He is not required to try to persuade the purchaser of these assets to employ his former employees. On the other side, the purchaser of the assets will not have the responsibility of offering employment to the former employees of that establishment. This situation is of course very unsatisfactory for the employees in general and does not protect their contracts of employment. Only the workers who refused to work for the new owner of the assets did not face a problem. Their contracts could not be transferred to the new owner without their consent nor could they be compelled to accept an employment offer from the new employer, which he would be free to give.[136]

1.3.4) The employment contract and s.38 of the Insolvency Act

As already mentioned above, it was decided in the late 19th century in *Clark v Denny*[137] that the insolvency of the employer constituted, under the common law, a breach of the employment contract. The principle that insolvency causes a breach of the employment contract was already a common law rule decades prior to the implementation of the Insolvency Act 24 of 1936. The legislator of the act followed the above-mentioned opinion of the court and adopted the rule of the common law. But section 38 of the Insolvency Act 24 of 1936 went further and stipulated not only that the insolvency of the employer would be considered a breach of the contract, but that the sequestration of the employer's estate terminates the contract of employment.

S. 38 of the Insolvency Act 24 of 1936 stipulated as follows:

> "The sequestration of the estate of an employer shall terminate the contract of service between him and his employees, but any employee whose contract of service has been to terminated shall be entitled to claim compensation from the insolvent estate of his former employer for any loss which he may have suffered by reason of the termination of his contract of service prior to its expiration."

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135 Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

136 Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

137 In 1884 EDC 300, 302.

This regulation was clear and stated that the employment contract will come to an end in the cases of the sequestration or the winding-up of the business.[138] The outcome for other rights and obligations in regard to or linked with the employment relationship was uncertain and will be discussed *infra*.

In cases of the applicable *mutatis mutandis* section 339 of the Companies Act, it was uncertain what would happen if the company would be able to pay its debts but nevertheless liquidation took place.[139] Only in circumstances where the company in liquidation was also unable to pay its debts, was the application of section 38 of the Insolvency Act clear.

There were thus two possible outcomes for the employment contract. According to the regulations of the Companies Act and the Close Corporations Act read with the Insolvency Act, the employment contract was only terminated if the company was unable to pay its debts. In cases where a solvent company or corporation was liquidated, there was no automatic termination of the employment contracts.[140]

1.3.5) The employment contract and rescue proceedings

Whereas the outcome of the employment contract in circumstances of the insolvency of the undertaking, which led to the company's closing, seemed to be clear and aligned with the insolvency law principles, it was questionable whether a termination of these contracts could also happen in cases where the trustee tried to continue working and to rescue the undertaking.

The rescue of the undertaking is a chance to salvage employment contracts and to reduce the potential for employees' claims.[141] The company law prior to 1995 offered some mechanisms to salvage an insolvent undertaking. These mechanisms were the so-called judicial management and schemes of arrangements and compromises. The latter opportunity involved schemes of arrangements and compromises in terms of section 311 of the Companies Act. Regarding the contracts of employment, one had to distinguish the situation where the company was to continue

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[138] Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSAR* 559, 559.

[139] As already mentioned *supra*.

[140] Olivier MP, Transfer of Undertakings and Insolvent Employers: A Comparative Enquiry and Implications for South African Labour Law (1995) *TSAR* 737, 744.

[141] Smit N, *Labour Law implications of the transfer of an undertaking*, 372.

to carry on the same business either with the same shareholder or with new ones from the situation where the business was sold.[142] In both cases the mere existence of a scheme of arrangement and compromise did not have an effect on the employment contracts of the concerned workforce. But because of the importance of the workforce within the undertaking's economic management, employment contracts would be affected in most cases of such schemes. In cases where the business is carried on, the employees will continue in undisturbed employment, unless the undertaking will dismiss them *bona fide* through operational or other requirements. The outcome for the employment contracts depends in respect to a sale of the undertaking on the special terms of the agreements.

Regarding the time when such schemes were entered into, it was of great importance whether the company already was being wound up or not. In the first case, i.e. where the scheme was entered into prior to a winding-up order, the dismissal of some or all of the company's employees was a condition of the scheme. These dismissals were not practically different from other dismissals. The employee joined the ordinary protection of the contract law and statutory law.[143] The situation was much more complicated when the company was already wound up. In such cases all employment contracts were terminated by section 38 of the Insolvency Act as stated *supra*. The courts usually made an order staying or setting aside the winding-up according to section 354 (1) of the Companies Act.[144] In the cases where this undertaking could be salvaged, the liquidator could re-employ some or all employees of the wound-up undertaking. The question whether their contracts would automatically be revived or stay alive will be considered *infra*.

The second possibility for a scheme of arrangement and compromise is where the business in terms of the scheme's provisions was transferred to a new owner.[145] The basic principle of the law of contract was that the employee could not be compelled to work for the new owner. On the other hand, an employee who wished to work for the new owner could not do so without the

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142 Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1323.

143 Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 563.

144 Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1324; Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 563.

145 It is confusing that Olivier MP and Potgieter O referred to a transfer "to a new employer", because the new owner of the business was not necessarily the new employer of the employees concerned of the insolvent undertaking. - Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1324.

consent of the transferee of the business. A transfer of the employment contract depended on the will of the transferee. As already decided in *East Rand Exploration Co v Nel,*[146] the consent of the employer as well as the consent of the employee was required. The transferee remained free to decide, whether or not he wanted to employ the worker. This opinion was probably not in favour of job security, but at least aligned with the principles of the common law. After the sale of a business the employees had no right to remain employed.

An exception to this principle was the case where the business was sold to another company within a group of companies or the controller of the transferred company remained the same after the transfer.[147] In such cases the courts could hold that the employment contracts were per se not affected by the transfer of the business.[148] But in such cases it was doubtful whether the owner of the business really changed. In all cases where the employee was willing that his contract would be transferred along with the business, intervention by legislature was necessary.[149]

One can therefore see that the South African law did not grant proper protection to employees in cases of the transfer of an insolvent business prior to 1995. The reason for this was the absence of a system that foresaw a transfer of employment by act of law.[150] The shortcomings regarding the protection of the employees through consultations or security for their contracts were based on the fact that company, insolvency and labour law did not properly heed the employees' interests vis-à-vis the interests of the other stakeholder, i.e. creditors, shareholders and the community in large.[151]

According to *Olivier* and *Potgieter,* the South African law could, especially in the rescue proceeding, learn a lot from European experiences.[152] They saw the complete overhaul of this field of law as a matter of the "utmost importance".

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146 See 1903 TS 42.

147 Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 565.

148 *SAAWU v Contract Installations* (IC) in *ILJ* 1988, 112 ff..

149 Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 565.

150 Olivier MP, Transfer of Undertakings and Insolvent Employers: A Comparative Enquiry and Implications for South African Labour Law (1995) *TSAR* 737, 749.

151 Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1326.

152 Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1325.

1.3.6) Transfer of existing rights and obligations to the transferee

The insolvency of the employer constituted under common law a breach of the contract of employment and enabled the trustee or liquidator to terminate the contract of employment.[153] Because sequestration and winding-up led, in accordance with section 38 of the Insolvency Act, to the termination of the contract of employment, one could at a first glance follow that all rights and obligations based on and related to that contract could not be transferred to the transferee. Regarding the rights and obligations following the contracts with third parties, the same result could follow. The wording of section 38 of the Insolvency Act covers only the termination of the single employment contract.

One has to distinguish between these employment contracts, other agreements and contracts within the relationship between employee and transferor. According to *Jordaan,* the transferee will have to decide whether he wants to terminate such contracts and agreements, e.g. collective agreements between a union and the transferor.[154] If third parties did not form a part of the employment contract, but if the rights and obligations are linked with the employment relationship concerned, it was also impossible to transfer these rights and obligations to a new employer. A major-minor content will from a practical point of view only lead to the result that in cases where even rights and obligations flowing forth from the contract of employment couldn't be transferred, rights and obligations in regard to third parties *a fortiori* could not be transferred to the transferee (*argumentum a maiori ad minus*).

1.3.7) Further Remuneration and Reinstatement

Very problematic and serious discussions arose from the question whether the employee could claim remuneration for the work that he had done after the sequestration and whether there could be a right to reinstatement on the basis of fairness.

Regarding the question of wages, one has to bear in mind that the contract of employment was terminated due to the insolvency on the effective date and that the transferee of the insolvent business was free to decide whether or not he wants to work with the old workforce or parts thereof. That is why there could not be a claim on wages based on this contract.

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[153] Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 938.

[154] Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 957.

The Industrial Court affirmed the possibility of a reinstatement in the case of *SA Boilermakers, Iron & Steelworkers, Shipbuilders & Welders Society v SA Cutlery (Pty) Ltd.*[155] In this case the Industrial Court argued that, in terms of s 43 of the LRA (1956), a reinstatement could be ordered even where the employer was in liquidation or where the employer had been sequestrated.

According to Olivier, Potgieter and the respondent in the above-mentioned case, it was doubtful whether such an approach was correct. The consequence of the wording of section 38 of the Insolvency Act was the termination of the employment contract and the possibility to claim for compensation for the employee concerned. It was questionable whether the Industrial Court had the competence to ignore the clear wording of section 38 of the Insolvency Act and the competence to order such a reinstatement solely on the basis of fairness.[156]

1.3.8) Information and Consultation

The transfer of the undertaking was usually linked to the employee's retrenchment which could lead to the loss of his livelihood. South African company and insolvency law provided neither a right to the employees to be informed nor a right to be consulted prior to the course of insolvency and rescue proceedings.[157] The reason for this lack of rights was that neither company nor insolvency law required *locus standi* for the employees, if they were not creditors of the insolvent undertaking. Only if they were creditors of the insolvent business would they have these rights.[158] In cases where the employees did not have the status of the undertaking's creditors, the insolvency law remained silent, and this seems to be the case in most of the establishments. Because of the lack of regulations in the insolvency and company law, one could take recourse to the stipulations of the labour law dealing with the closure of a business.

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[155] (IC) in *ILJ* 1988, 1106.

[156] Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1321 with further references.

[157] Blackman M, The employee and the insolvent company (1993) *ILJ* 543, 544; Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1325.

[158] If the undertaking owed them wages, they would have the status of a creditor of the undertaking.

Section 1 (b)(ii)(bb) of the LRA (1956) provided for fair labour practice in circumstances, where

> "[t]he termination of the employment …unless-…
> prior consultations in regard to such termination of employment took place with such other employee or where the employee is represented by a trade union or body recognised by the employer as representing the employees or any group of them, with the trade union, body or group; … "

Against the background of this statutory provision, the Industrial Court protected the rights of the employees through the introduction of procedural requirements which the employer had to fulfil prior to the dismissal. The most important duty for the employer was the requirement of consultation, which will be considered *infra.*

The aim of these consultations was the consideration of alternatives to the retrenchments, e.g. the transfer of the employees to other workplaces within the employers' organisation.[159] In the important decision of *Ntuli & others v Hazelmore Group t/a Musgrave Nursing Home,*[160] the Industrial Court went beyond this requirement. Following that decision, the seller had to attempt to involve the purchaser of the business in the consultation process prior to the sale and retrenchment.[161] The goal of that requirement was to consider, whether the new owner of the business would have the opportunity to employ the employees of the seller on mutually acceptable terms. One has to bear in mind that the guidelines of the court in this regard did not offer the employees the right to be taken over by the purchaser. The duty of the purchaser to take the old workforce into employment was not foreseen.[162] A substitution of the transferor by the transferee in regard to employment contracts had no statutory basis.

Regarding the disclosure of information and the right of the employees or their representatives to be consulted, the Industrial Court stated that,

> "[a]n employer, the transferor, who parts with an undertaking as a going concern should consult with his employees and their representatives in regard to the possible consequences of the take-over. The transferee should also be involved in these consultations or at least consult separately with the employees and their union. An agreement, which may be arrived at would ordinarily be enforced by the courts. Such an agreement could provide for the possibility of retrenchments following the transfer of the undertaking."[163]

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[159] Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

[160] (IC) in *ILJ* 1988, 709 ff..

[161] (IC) in *ILJ* 1988, 709 ff.

[162] Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

[163] (IC) in *ILJ* 1988, 709, 719.

There was obviously a loophole in the regulations regarding the disclosure of information and consultation in transfer matters. It was then questionable if the interests of the affected persons in situations of transfer and retrenchment would require an application in the way of analogy. The similarity of interests is the basis for an analogy, i.e. the application of the same principles to different situations.

Under common law the transfer of the employment contract depended on the consent of the employee. To decide whether he shall consent to the transfer of his contract, the employee needed to know something about the new employer. The disclosure of information constituted an important logical basis for the decision making of the employee. The transfer may result in practical consequences for employees that they may need to prepare for in advance (for example, new travel arrangements, retirement planning, etc.).[164] These examples show the interests of the employee, who would be affected by a transfer of the business. The situation of this employee is comparable with the situation of an employee who might to be retrenched. The question, which was examined by the Industrial Court, addressed the problem as to what extent there should be consultation between employer and employees.

The above-mentioned roots of fair labour practice, fairness and equity, which required the employer to consult with the affected employees prior to their retrenchment, were not limited to consultations prior to the disposal of the business.[165]

Roth AM held in *Numsa v Metkor Industries*[166] as follows:

> "It is a requirement that, if it is a consequence that employees' interests shall or even may be affected (and not necessarily only in regard to retrenchments), the employees are entitled to be kept informed, from the earliest possible reasonable time, to the extent that it is reasonably necessary to enable them to consult with management in regard only to such matters as reasonably affect them, at the time taking into account the lawful, reasonable and fair requirements of management to preserve security."[167]

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[164] Smit N, *Labour Law implications of the transfer of an undertaking*, 304.

[165] *Roth AM* (IC) in *ILJ* 1990, 1116, 1124 H.

[166] (IC) in *ILJ* 1990, 1116 ff..

[167] (IC) in *ILJ* 1990, 1116, 1123 G.

After the recognition of a requirement to inform and consult the employees or their representatives, one had to answer the question as to what the term consultation in these circumstances meant, i.e. to what extent the employer had to inform and consult. According to the Industrial Court's decision in *Combined Small Factory Workers Union & others v Aircondi Refrigerator (Pty) Ltd,*[168] the demand to consult did not mean that real negotiations would be required. In the decision in *Hadebe & others v Romatex Industrials Ltd*[169] *Bulbulia* examined the meaning of "consultation".[170] He considered definitions of numerous dictionaries to conclude what consultation means, with regard to retrenchments, namely "to seek another's approval of a course already decided on".[171] The Labour Appeal Court stated in *Mohamedy's v CCAWUSA (Commercial Catering & Allied workers Union of SA)*[172] that the employer cannot make a final decision regarding a closure of his business without prior consultation with the employees and unions. The reason for that demand was to give the employees the opportunity to persuade the employer that the retrenchment is unnecessary and that there are alternative measures possible, e.g. wage reductions.

In its decision to *National Union of Textile Workers Union v Braitex*[173]*,* the Industrial Court stipulated

> "If proper alternatives are found this could mean that the employer could change its mind and not proceed with the closure. Although the final decision to close rests with the employer and the employees should not be ignored or dealt with in a highhanded manner."[174]

Again, South African insolvency and company law did not require the employer to consult with affected employees or their representatives. In analogy to the decision above, one could state that a consultation is required prior to the course of insolvency or rescue proceedings.

It remained unclear at which point the consultations or disclosure of information should take place – whether it would be before the employers' decision to wind up, or before or after the application for the wind-up order.[175] Because of the differences between labour law, insolvency law

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168 (IC) in *ILJ* 1990, 532, 550 E.

169 (IC) in *ILJ* 1986, 726, 733.

170 He called the possibility to examine this term "a great deal", because "consultation" was in his opinion the most important term of the section.

171 From Herbert V Prochnow, *Speaker's Handbook of Epigrams and Witticisms*.

172 (LAC) in *ILJ* 1992, 1174, 1174.

173 (IC) in *ILJ* 1987, 794 ff..

174 (IC) in *ILJ* 1987, 794, 799 (H).

175 Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1321.

and company law regulations, one should keep in mind that the right to be informed was very restricted. There were several points which created the burden on the right of consultation. The consultation requirements could not go further than the abilities of the employers could reach. The consultations were no longer possible after a court had granted an order for the winding up or sequestration of estate. The same situation occurred when the court had already sanctioned an agreement or scheme between the employer and his employees or their union. The requirement to disclose information and the right to be consulted were, according to the Industrial Court, the consequences of the application of fair labour practices principle to the transfer of an undertaking, as already stated above.

1.4) Conclusion of Chapter One

Prior to the implementation of section 197 LRA (1995), there was no provision for a transfer of employment contracts by operation of law in cases of the transfer of an undertaking. The contract of employment was terminated by the sale, closure and insolvency of an undertaking. If the concerned parties had the will to transfer the employment contracts in transfer circumstances, they had to enter into an agreement between the employee, transferor and transferee to transfer the contract of employment. The need for the consent of the employee was intended to respect their right to freedom of contract. Because of the problem of high unemployment, this approach resulted in a position where employees did not enjoy continuity of employment and where their right to freedom of contract was actually disadvantageous to them. Because of the unsatisfactory social security system, the employees found themselves in a very insecure and unsatisfactory position. This situation made a change of the statutory provisions necessary.

The Industrial Court was not willing and not able to incorporate principles of automatic transfer of employment contracts into the South African law in the event of the transfer of an undertaking, because of the absence of a corresponding statutory right. The Industrial Court evaluated the fairness of any retrenchments in these circumstances. Because of the lack of a legislative stipulation, the South African courts could only assist employees to a limited extent. The Industrial Court set high standards for considering a dismissal on operational requirements in circumstances of a transfer to be fair and valid.

Despite these disadvantages to employees, one has to recognise that the legal framework of common law, the LRA (1956) and the Insolvency Act was aligned in transfer matters. All three legal roots provided the same result in insolvency matters in respect to the employment contract. The breach of the contract and, according to the statutory law, termination of the employment contract were consequences in circumstances where an undertaking was transferred. It did not matter whether the transferred business faced insolvency prior to the transfer or not. The lack of statutory regulations was certainly employer-friendly, because he was enabled to base his decisions mostly on his own business ideas and plans. A basic protection of the employees could have been reached through the introduction of the fair labour principles jurisdiction. A balance of several of the employer's interests and employee's interests was thus possible, even without a statutory regulation of the effect of a transfer of undertakings for employment contracts.

2) Chapter Two – Situation between 1995 and 2002

Because of the changes in South Africa in the early 1990s, several changes to the South African legal system were necessary in response to the needs of the new political, economic and social situation. The South African legislator had the opportunity to create a completely new law or to take recourse to other legal systems. With regard to the transfer of (insolvent) undertakings, several possibilities could be found abroad as stated *supra*.

2.1) The South African Labour Law between 1995 and 2002

2.1.1) Needs and Developments during the early 1990s

As described above, South African labour law was adapted to face numerous challenges during the late 1970s and 1980s. Labour law had to be developed to make the South African economy attractive for foreign investors, to increase the standard of living in South Africa and to bring black employees on board in respect of collective bargaining and to ensure a fair labour relations system. The reforms of the government couldn't stop the crisis of the economy. By the 1980s the Gross Domestic Product (GDP) was averaging a 0,7% increase per year. In the early 1990s this tendency of growth ended finally and led to a 2,1% decrease of the GDP in 1992.[176] Though the South African government took several modernising measures towards labour and economic reforms, there was still a need for substantial reforms after 1994. In 1992 the fact-finding committee of the ILO found that certain regulations of South African labour law were not in harmony with international standards, e.g. the freedom of association, the pre-strike procedures as well as the dispute resolutions.[177]

2.1.2) The constitutional basis of the post-apartheid labour law

Section 3 of the LRA (1995) provided that any interpretation of the Act should

> "(a) give effect to the primary objects of the Act;
> (b) be in accordance with the constitution;
> (c) be in accordance with public international law."

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[176] Du Toit D *et al*, *The Labour Relation Act of 1995* (1999), 19.

[177] Du Toit D *et al*, *The Labour Relation Act of 1995* (1999), 22.

S. 3 (b) of the LRA (1995) called for compliance with the Constitution. The provisions of the Labour Relations Act had to be in accordance with, and subordinated to, the South African Constitutions. The interim Constitution[178] was the basis of the new legislation and its adoption was thus more significant than the introduction of the LRA (1995).[179] That is why the interim Constitution[180] was of great importance for employees' and employers' rights. Chapter three of that constitution provided for collective labour relation rights.

Section 27 of the interim constitution contained the right to fair labour practices as well as the right to form and join unions or employers organisations, to organise and bargain collectively as well as the right to strike. The extraordinary position within the section enhances the importance of the fair labour practices principle for the new labour law.

> "**Section 27 Labour relations**
>
> (1) Every person shall have the right to fair labour practices.
>
> (2) Workers shall have the right to form and join trade unions, and employers shall have the right to form and join employers' organizations.
>
> (3) Workers and employers shall have the right to organize and bargain collectively.
>
> (4) Workers shall have the right to strike for the purpose of collective bargaining.
>
> (5) Employers' recourse to the lockout for the purpose of collective bargaining shall not be impaired, subject to Section 33 (1)."

Because of the protection of these rights as well as of the other rights within this "bill of rights", it was not possible for legislative or executive organs to encroach on these rights.[181] It was necessary to establish a labour law which had to be in line with the Constitution.

Only three years after its implementation the interim constitution was replaced by a new constitution. On 4 February 1997[182] the new South African Constitution came into effect.[183]

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178 Act 200 of 1993; Government Gazette 343, no. 15466 of the 28 January 1994.

179 Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 923, 923.

180 The interim Constitution came into effect on the 27th April 1994.

181 Du Toit D *et al*, *The Labour Relation Act of 1995* (1999), 21.

182 This date follows from the "Proclamation by the president of the Republic of South Africa" of the 22nd January 1997; some authors consider the 7th February 1997 as the date, when the constitution came into force.

183 Act 108 of 1996; according the Citation of the Constitution Act 5 of 2005 hereinafter the "constitution".

The regulations of the LRA (1995) had thus to be aligned with the new constitution. It had to protect the rights provided for in the Constitution. Section 23 of the Constitution is the constitutional basis for the labour relations provisions and provides as follows:

> **"Section 23 Labour relations**
>
> (1) Everyone has the right to fair labour practices.
>
> (2) Every worker has the right -
>
> (a) to form and join a trade union;
>
> (b) to participate in the activities and programmes of a trade union; and
>
> (c) to strike.
>
> (3) Every employer has the right -
>
> (a) to form and join an employers' organisation; and
>
> (b) to participate in the activities and programmes of an employers' organisation.
>
> (4) Every trade union and every employers' organisation has the right -
>
> (a) to determine its own administration, programmes and activities;
>
> (b) to organise; and
>
> (c) to form and join a federation.
>
> (5) Every trade union, employers' organisation and employer has the right to engage in collective bargaining. National legislation may be enacted to regulate collective bargaining. To the extent that the legislation may limit a right in this Chapter, the limitation must comply with section 36(1).
>
> (6) National legislation may recognise union security arrangements contained in collective agreements. To the extent that the legislation may limit a right in this Chapter, the limitation must comply with section 36(1)."

The constitutional basis for the LRA (1995) was set out in the first paragraph of section 23. The concept of fair labour practice was a result of the political developments in South Africa during the first half of the 1990s, but also a consequence of labour law developments during the 1970s, i.e. the reports of the Wiehahn Commission. In accordance with section 23 (1) of the Constitution, fair labour practice was of fundamental importance for the transfer of undertaking matters too. The negative effects resulting from such a transfer had to be neutralised as much as possible by the new labour law.[184]

But as *Landman J* stated in *National Entitled Workers Union v CCMA & others*[185]

> "[t]he LRA is not intended to regulate exhaustively the entire concept of a 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".[186]

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[184] Smit N, Should Transfer of Undertakings be statutory regulated in South Africa? (2003) *Stellenbosch LR* 205, 209.

[185] (LC) in *ILJ* 2003, 2335 ff.

2.1.3) The five-year plan and the formation of NEDLAC

In reaction to the need to resolve the economic problems after 1994, the Ministry of Labour initiated a five-year plan to reform and modernise South African labour law. The reasons for the establishment of a new act can be seen in section 1 of the Labour Relations Act (1995). This section states that the purpose of the Act is to advance economic development, social justice, labour peace and the democratisation of the workplace by fulfilling the primary objects of the Act. According to section 27 of the interim Constitution and section 23 of the Constitution, everyone has the right to fair labour practices. The legislator had to give effect to this fundamental right within the provisions of labour legislation.

The five-year plan envisaged the restructuring of the Department of Labour, the reform of labour legislation and the development of an active labour market policy.[187] This initiative dealt not only with the legal framework, but also with the institutions for the regulation of the labour market.[188] On the one hand, the earlier inclusion of black workers under the term "employee" and the possibility to register new black and mixed coloured unions was a big step towards ensuring democratic standards in society. On the other hand, there were still problems, i.e. the complexity of labour law in general[189] and several ad hoc amendments. This led to unnecessary complexity and judicial confusion. The inconsistent statutes dealing with labour law resulted in a lack of integrated legislation for the regulation of the labour market.

To resolve the crisis of the labour market, it was of great importance to repeal the LRA (1956). But to achieve this effectively all stakeholders had to be consulted. The first step was to create a body which represented all interested parties. The National Manpower Commission (NMC), which had already been established according to the recommendation of the Wiehahn Commission, represented as a permanent body not only the interests of the state, but also the interest of the social partners on the level of the undertakings, as well as the employers and the employees. The Commission had the power to investigate the problems and to recommend their opinions to the Minister of Labour.[190] In 1994 the National Economic, Development and Labour

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186 (LC) in *ILJ* 2003, 2335, 2340.

187 *The Innes Labour Brief* (1994) 6 (1), 58ff..

188 Du Plessis JV *et al*, *A Practical Guide to Labour Law* (2002), 197.

189 In Germany labour relations are regulated in more than fifty legislative Acts and more than 64.000 bargaining agreements.

190 ANC, *Non-Racial Trade Unionism in Historical Perspective*, 65f.

Council Act 35 of 1994 came into effect, and the National Economic, Development and Labour Council (NEDLAC) was established. According to this Act, NEDLAC would strive to endorse the aims of economic growth, participation in economic decision-making and social equity. NEDLAC had to consider all significant changes before these social and economic matters and introduce them to the legislature.[191] The social partners in NEDLAC had reaffirmed their unequivocal commitment to human rights and workers' rights. This was consistent with the history of the struggle for human rights in South Africa as stated *supra*. "The social partners affirmed that trade and investment liberalisation and the integration of the South African economy into the global economy must promote economic and social progress and not undermine social protection. They commit themselves to working together within the tripartite framework of NEDLAC to ensure the ratification and observance in South Africa of the core ILO conventions embodying universally recognised labour standards."[192]

2.1.4) The Draft Labour Relations Bill

In August 1994 a legal task team was appointed by the Minister of Labour to draft a Labour Relations Bill. The reform of the labour legislation, required by the five-year-plan of the Ministry of Labour, had to be in compliance with the interim constitution of 1994 and also with international standards found in the ILO conventions of the International Labour Organisation (ILO).[193] For the latter reason, the ILO provided experts and resources for the task team.[194] In early 1995 the so-called Draft Bill (Draft negotiating document in the form of a Labour Relations Bill) was ready to initiate a process of discussion and negotiation. The Draft Bill was then published for public comment.[195] Individuals and Organisations, i.e. Business South Africa (BSA) and COSATU made about 280 submissions to the Draft Bill.[196] Finally, the South African Parliament passed the new Labour Relations Act in September 1995 by an overwhelming majority.

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[191] Du Plessis JV *et al*, *A Practical Guide to Labour Law* (2002), 199; See also Smit N, *Labour Law implications of the transfer of an undertaking*, 12.

[192] Smit N, *Labour Law implications of the transfer of an undertaking*, 36.

[193] ILO Convention 158 and Recommendation 166 of 1982 stated obligations of employers regarding the termination based on operational requirements. Although they did not address the transfer matters directly, they laid down broad procedural guide-lines. - Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 941.

[194] The three experts were A. Adiogun (Lagos), B. Hepple (Cambridge) and M. Weiss (Frankfurt).

[195] General Notice 97/1995 Government Gazette 16259 of 10th February 1995 (Ministry of Labour).

[196] Du Toit D *et al*, *The Labour Relation Act of 1995* (1999), 27.

2.1.5) The Labour Relations Act 66 of 1995

Because of a delay,[197] which was caused by the introduction of the Commission for Conciliation, Mediation and Arbitration (CCMA),[198] the LRA (1995) came into operation on 11 November 1996. The Industrial Court's jurisprudence, especially its philosophy regarding fair labour practices, was essentially codified in section 23 (1) of the Constitution and found expression in a number of provisions of the LRA (1995).[199]

The aim of the LRA was not only to redress the uncertainties of the current South African labour law, but also to develop a new labour relations system. This was because the system had to be able to meet the challenges of recent international developments and the globalisation of markets. To do so, the drafters not only had to codify the jurisprudence of the Industrial Court from the 1980s and 1990s, but also to extend the protection of employees and to provide for effective collective bargaining mechanisms as well.[200]

The LRA included all employees independent of their colour, race or sex, and was thus applicable to every employer and every employee in every undertaking. The only exceptions were made for the members of the National Intelligence Agency, the South African Secret Service and the South African Defence Force. The legislation for the agricultural, educational and public service sectors was also eventually included under the LRA.

But though every single employee should be treated in the same way as stipulated by the new LRA (1995), it is doubtful if all employees will actually be treated equal in circumstances of the transfer of an undertaking. It is possible that the difference in the financial status of transferors would lead to different legal consequences. In this respect it should be mentioned that the right to equality before the law does not require that *all* persons must be treated identically in *all* circumstances.[201]

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197 Which certainly did not correspond with the requirement of the Minister of Labour for "speed and serious negotiation" – Du Toit D *et al*, *The Labour Relation Act of 1995* (1999), 27 footnote 130.

198 The necessity results from the fact that the CCMA took over much of the dispute resolution of the Department of Labour and the Industrial Court. – Du Toit D *et al*, *The Labour Relation Act of 1995* (1999), 27.

199 Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 923, 923; Smit N, *Labour Law implications of the transfer of an undertaking*, 23.

200 Du Toit D *et al*, *The Labour Relation Act of 1995* (1999), 39.

201 Devenish GE, *A commentary on the South African Bill of Rights*, 43-45.

2.2) The South African Insolvency Law between 1995 and 2002

During the implementation of the LRA, i.e. the period between 1994 and 2002, the Insolvency Act, 24 of 1936 remained unchanged. The provisions dealing with the outcome of the employment contract in insolvency matters were not changed. The problems which arose from the interplay between regulations of the Insolvency Act and the LRA, which provided for a modern view on labour relations, will be considered *infra.*

2.3) The Transfer of Undertakings between 1995 and 2002

Regarding the transfer of undertakings, the South African legislature faced the possibility to establish completely new legislation. Because of numerous changes in South African society and the economy, the statutory provisions for labour relations had to be changed as stated *supra.* The decision to include section 197 in the final Act was a policy decision, taken with due regard to general socio-economic as well as economic factors[202] and largely the outcome of negotiations at NEDLAC.It could thus be described as a negotiated compromise.[203]

2.3.1) The Acquired Rights Directive as the key source of section 197 LRA

As already stated *supra,* the South African legislator intensively considered employment law legislation abroad. Several other jurisdictions allowed a transfer of the employment contracts by an act of law, while others did not.[204] One should keep in mind the importance not to constrain the right to purchase and to sell such assets, because this would also restrict the right of the owner to restructure the purchased undertaking.[205]

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[202] Smit N, *Labour Law implications of the transfer of an undertaking*, 25.

[203] Smit N, *Labour Law implications of the transfer of an undertaking*, 25.

[204] Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1388.

[205] Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1393.

This was stated in the case of *NLRB v William J Burns International Detective Agency*[206] as follows,

> "A potential employer may be willing to take over a moribund business only if he can make changes in the corporate structure, composition of the labour force, work location, task, assignment, and the nature of supervision. Saddling such an employer with the terms and conditions of employment contained in the old collective bargaining contract may make these changes impossible and may discourage and inhibit the transfer of capital."

The possible interest of the transferee to change the labour force or the old collective bargaining contracts makes it clear that the interests of the employees concerned need to be protected. Judge Harlan used the following argument in the case of *John Wiley & Sons v Livingston,*[207]

> "The objective of the national labour policy, reflected in established principles of federal law, require that the rightful prerogative of owners independently to rearrange their business and even to eliminate themselves as the employers be balanced by some protection for the employees from a sudden change in the employment relationship."

The above statements show the interests of the employer as well as the necessity to protect the employees. However, it is questionable whether such an approach to the matter is in fact impartial and entails a real balancing of the different interests. It is important to mention that, in respect of the employment contracts, there are several possibilities. There are two extremes, which will be in favour of the employers' business and profit interests on one side, and in an extreme manner providing for a continuity of the employment on the other side.

If one prefers employment contracts on an at-will basis, the automatic termination of the contracts at the date of the transfer would be the consequence. This is the consequence of a system based on hire and fire. The fundamental common law rule in the United States is that all employment contracts are concluded on an at-will basis, unless otherwise agreed.[208] This position is strictly in favour of flexibility on the part of the owners' capital[209] and could probably lead to an investment-friendly climate of the economy.

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206 United States Supreme Court in 406 US 272, 287 (1972).

207 United States Supreme Court in 376 US 543 at 547 (1964).

208 Ahanchian AJ, Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision (2002) *Chicago-Kent Journal of International and Comparative Law*, 29, 32.

209 The individual rights of American workers are preserved by labour union agreements, state statutes and private contracts – Ahanchian AJ, Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision (2002) *Chicago-Kent Journal of International and Comparative Law*, 29, 29.

If one tries to provide for an unchanged employment of the labour force, an automatic transfer of the employment contract would be necessary. The result would be continuity of employment, without any notice to the employees and consideration of the different interests of the affected employees and employers. This expression of the international movement for the protection of employees, especially the opinions of the European legislature[210] and the implementation of their directives to the member states' law, showed to the South African legislator a well-established system of worker protection in cases of transfers of businesses.[211] But in doing so the autonomy of the employees and employers was overridden by the interest of achieving a greater collective good, as will be considered in detail *infra*.[212]

The European position tries to protect the employees' interest of job security.[213] According to the preamble of the ARD,[214] it has the purpose

> "to provide for the protection of employees in the event of a change of employer, in particular to ensure that their rights are safeguarded."

The reasons for this point of view can be found in the historical influences and the development of legal and social policies.[215] As already stated, the ARD was established within the Social Action Programme of the EEC of 1974.

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[210] The preamble of the Acquired Rights Directive fixes the goal of the Directive "to provide for the protection of employees in the event of a change of employer, in particular to ensure that their rights are safeguarded".

[211] Smit N, Automatic transfer of employment contracts and the power to object (1997) *TSAR* 1997, 548, 549.

[212] See also Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 3.

[213] In Germany, employees' rights in the event of a change of the identity of their employer were protected already prior to the implementation of the European provision of Directive 77/187/EEC. After decades of discussion the German legislature passed a statutory provision that dealt with the transfer of employment matters. This provision was enacted by § 122 of the Works Constitution Act (BetrVG) and provided for the introduction of a new § 613a to the BGB. This implementation of § 613a BGB to the German civil law occurred on 19 July 1972 and tried to answer the above-mentioned question, how to handle the employment contract in circumstances, where a business was transferred. This happened under the social democratic-liberal government of the well-known Chancellor Willy Brandt. But this version of § 613a BGB was not compatible with the implication of workers protection following from the Council Directive 77/187/EEC of 14 February 1977. That is why the German legislature amended its former stipulation in 1980 by an EEC Adaptation Act. In addition to the former version, the amended version of § 613a BGB stated that the transfer of rights and duties arising from collective bargaining agreements and works agreements were guaranteed. These amendments came into effect in 1980.

[214] History and content of this Directive will be considered *infra*.

[215] Ahanchian AJ, Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision (2002) *Chicago-Kent Journal of International*

The Social Action Programme of the EEC of 1974 included three important EC Council Directives for the protection of employees' rights dealing with the matters of collective redundancies,[216] transfers of undertakings and insolvency. The directives were enacted in 1975, 1977 and 1980 respectively.[217] The Directorate General V, an agency of the EU Commission, drafted Directive 77/187/EEC, the so-called EC Acquired Rights Directive (ARD). This Directive of the Council was, according its article 1, applicable

> "to the transfer of an undertaking, business or part of a business to another employer as a result of a legal transfer or merger."

The ARD provided in article 3,

> "1. [t]he transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer within the meaning of Article 1 (1) shall, by reason of such transfer, be transferred to the transferee.
> Member States may provide that, after the date of transfer within the meaning of Article 1 (1) and in addition to the transferee, the transferor shall continue to be liable in respect of obligations which arose from a contract of employment or an employment relationship…"

Article 4 protected the employees concerned from dismissals as it fixed,

> "1. The transfer of an undertaking, business or part of a business shall not in itself constitute grounds for dismissal by the transferor or the transferee. This provision shall not stand in the way of dismissals that may take place for economic, technical or organizational reasons entailing changes in the work-force."

The ADR had to be implemented by the member states of the EC, because Article 8 provided as follows:

> "1. ….Member States shall introduce into their national legal systems such measures as are necessary to enable all employees and representatives of employees who consider themselves wronged by failure to comply with the obligations arising from this Directive to pursue their claims by judicial process after possible recourse to other competent authorities."

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and Comparative Law, 29, 33.

[216] Where 10% of the work force is reduced over a period of 30 days.

[217] The Directive of 20 October 1980 80/987/EEC deals with matters of Insolvency.

2.3.2) The content of section 197 LRA (1995)

In February 1995 the so-called Draft Bill was released for public comment. In its clause 92 the transfer of undertakings was regulated. It stated as follows:

> "(1) Save as provided by subsection (2), no contract of employment shall be transferred from one employer to another without the consent of the employee.
> (2) Where a trade, business or undertaking is transferred as a going concern, either in whole or in part, the contracts of all employees employed at the date of the transfer shall automatically be transferred to the transferee.
> …
> (4) Where a trade, business or undertaking is transferred, either in whole or in part, in circumstances where the trade, business or undertaking is being wound up for reasons of insolvency, the contracts of all employees employed at the date of the transfer shall automatically be transferred to the transferee, but all the rights and obligations between each employee and the transferor at that date shall remain rights and obligations between each employee and the transferor, and anything done before the transfer by the transferor in respect to each employee shall be deemed to have been done by the transferor."

After numerous submissions to this draft, the legislature also amended its clause 92. The introduction of section 197 LRA occurred in accordance with principles laid down by the Industrial Court.[218] However, the decision to include section 197 LRA was a policy decision and could be described as a negotiated compromise of NEDLAC. The legislature went further than the jurisprudence of the Industrial Court. Section 197 LRA (1995) provided as follows,

> **"197. Transfer of contract of employment**
> (1) A contract of employment may not be transferred from one employer (referred to as "the old employer") to another employer (referred to as "the new employer") without the employee's consent, unless-
> (a) the whole or any part of a business, trade or undertaking is transferred by the old employer as a going concern; or
> (b) the whole or a part of a business, trade or undertaking is transferred as a going concern-
> (i) if the old employer is insolvent and being wound up or is being sequestrated; or
> (ii) because a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency.

[218] Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1391.

> (2) (a) If a business, trade or undertaking is transferred in the circumstances referred to in subsection (1)(a), unless otherwise agreed, all the rights and obligations between the old employer and each employee at the time of the transfer continue in force as if they were rights and obligations between the new employer and each employee and, anything done before the transfer by or in relation to the old employer will be considered to have been done by or in relation to the new employer.
>
> (b) If a business is transferred in the circumstances envisaged by subsection (1)(b), unless otherwise agreed, the contracts of all employees that were in existence immediately before the old employer's winding-up or sequestration transfer automatically to the new employer, but 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, and anything done before the transfer by the old employer in respect of each employee will be considered to have been done by the old employer.
>
> (3) An agreement contemplated in subsection (2) must be concluded with the appropriate person or body referred to in section 189(l).
>
> (4) A transfer referred to in subsection (1) does not interrupt the employee's continuity of employment. That employment continues with the new employer as if with the old employer.
>
> (5) The provisions of this section do not transfer or otherwise affect the liability of any person to be prosecuted for, convicted of, and sentenced for, any offence. "

Section 197 LRA came into effect on 1 November 1996 and was the first of its kind in South Africa, as pointed out in the decision of the Labour Court in *Schutte & Others v Powerplus Performance (Pty) Ltd & Another.*[219] The possibility to transfer employment contracts by operation of law was, according to *Olivier* and *Potgieter,* a major shift in the approach away from the then current position in South Africa, i.e. the position prior to 1995.[220] Some authors emphasised the comparability of section 197 LRA with the regulation of the European Community, the Acquired Rights Directive (ARD).[221] Because the ARD provided for the automatic transfer of the employment relationship with all is rights and obligations, some authors argued that section 197 LRA would also provide for an automatic transfer of the employment contract.[222] But this seems only to be an opinion regarding the regulations other than the first half sentence of section 197 (1) of the LRA. *Le Roux* wrote authoritatively that the provisions of the first half sentence of section 197 (1) was nothing new and merely confirmed the common law principle that an employee's contract of employment

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[219] (LC) in *ILJ* 1999, 655ff..

[220] Olivier MP & Potgieter O, The legal regulation of employment claims in insolvency and rescue proceedings: A comparative Inquiry (1995) *ILJ* 1295, 1327.

[221] Abl. EG Nr. L 61/26.

[222] Smit N, *Labour Law implications of the transfer of an undertaking*, 74; Smit N, Word Werksekuriteit gewaarborg in die lig van artikel 197 van die Wet op Arbeitsverhoudinge 66 van 1995? (1997) *TSAR* 548, 548; Olivier MP, Transfer of Undertakings and Insolvent Employers: A Comparative Enquiry and Implications for South African Labour Law (1995) *TSAR* 737, 737.

cannot be transferred without his consent.[223] The word "unless" can only (on any principle of logic, language and interpretation)[224] mean that, in the circumstances described in (1)(a) and (b), the contract will be transferred, even if the employee does not consent to the transfer. Under the circumstances described in section 197 LRA (1)(a) and (1)(b), the transfer of the employment contract occurs by act of law. Though section 197 of the LRA had changed the common law relating to the relationship between employer and his work force at the time of the sale of a business,[225] one has to keep in mind that section 197 of the LRA acknowledged the principle of the common law and required the consent of the employee in its first sentence of subsection (1).[226] In accordance with section 197 (4) of the LRA, *Froneman* held in *Foodgro, a division of Leisurenet Ltd v Keil,*[227] that the transfer does not interrupt the continuity of employment of the employees.[228]

2.3.3) Problems with the wording of section 197 LRA

S. 197 of the LRA attracted much criticism because of its unclear text. Like clause 92 of the Draft Labour Relations Bill, section 197 LRA led to numerous uncertainties about its wording and legal effect. Numerous conflicting explanations were the outcome of these uncertainties.[229] *Blackie* and *Horwitz*[230] evaluated the situation after the enactment of section 197. They pointed out that practitioners were confronted with several difficulties because of its wording.

2.3.3.1)"Transfer"

The first problem was posed by the title of section 197 of the LRA. Regarding the phrase "transfer of undertaking", one had to make clear what the term *transfer* meant, in other words what constituted a transfer and when it came into effect. It was questionable whether and under which circumstances a share sale or asset deal would fall under section 197 of the LRA.

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223 Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 13.

224 Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 3.

225 Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1387.

226 Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 13.

227 (LAC) in *ILJ* 1999, 2521 ff.

228 (LAC) in *ILJ* 1999, 2521, 2529 (A).

229 Smit N, Automatic transfer of employment contracts and the power to object (2003) *TSAR* 465, 465.

230 Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1394.

Prior to the examination of the different South African approaches to a definition of this term, the European struggle shall be examined. Although the ARD had in article 2 defined the terms "transferor", "transferee" and even "representatives of the employees", the definition of the transfer was left to the courts. The question of when the ARD would be applicable was to be answered by applying a two-stage test. The first step was the examination of the position prior to the transfer. The court had to determine the question whether there was an identifiable economic entity carried on by the transferor. The second stage was to answer the question whether this economic entity retained its identity.

The first leading decision of the European Court of Justice was the decision in *Jozef Maria Antonius Spijkers v Gebroeders Benedik Abattoir CV et Alfred Benedik en Zonen BV*.[231] The European Court of Justice argued that

> "it is clear that the term ' transfer ' implies that the transferee actually carries on the activities of the transferor as part of the same business.
>
> 11 That view [of the Netherlands' government] must be accepted. It is clear from the scheme of directive no 77/187 and from the terms of article 1 (1) thereof that the directive is intended to ensure the continuity of employment relationships existing within a business, irrespective of any change of ownership. It follows that the decisive criterion for establishing whether there is a transfer for the purposes of the directive is whether the business in question retains its identity.
>
> 12 Consequently, a transfer of an undertaking, business or part of a business does not occur merely because its assets are disposed of. Instead it is necessary to consider, in a case such as the present, whether the business was disposed of as a going concern, as would be indicated , inter alia , by the fact that its operation was actually continued or resumed by the new employer , with the same or similar activities .
>
> 13 in order to determine whether those conditions are met, it is necessary to consider all the facts characterizing the transaction in question, including the type of undertaking or business, whether or not the business' s tangible assets, such as buildings and movable property, are transferred, the value of its intangible assets at the time of the transfer, whether or not the majority of its employees are taken over by the new employer, whether or not its customers are transferred and the degree of similarity between the activities carried on before and after the transfer and the period, if any, for which those activities were suspended . It should be noted, however, that all those circumstances are merely single factors in the overall assessment which must be made and cannot therefore be considered in isolation."[232]

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[231] (ECJ) in *ECR* 1986, 1119 ff..

[232] (ECJ) in *ECR* 1986, 1119ff. at para 10-13.

According to *Van Niekerk,* it is in South Africa and elsewhere "generally accepted" that a transfer in the sense of section 197 LRA does not include the acquisition of control caused by the transfer of shares.[233] The main problem with this view is that there could in fact be a change of the persons who control the business because of the number of their shares. Should new persons control the undertaking, these persons will have a great influence on the relationship between the employee and the employer, although the employer remains *de iure* the same person as prior to the transfer of shares. Because section 197 of the LRA is not applicable to a transfer of shares, the employee is not allowed to terminate his contract, if the control of the business he is working for has changed.[234] If one would accept the person who controls the work as the practical employer, one has to assume that the exclusion of transfer of shares from the applicability of section 197 of the LRA could be a departure from the common law rule that an employee has the right to choose his employer. But the employee, of course, has the possibility to resign from working for the company. It is not necessary that the employer informs and consults the representatives of the employees in this regard. The sale of a controlling shareholding is the most common method for the transfer of the control of companies.[235] It is certainly not the most advantageous possibility to exclude this method from the scope of section 197 LRA.

Provisions protecting the right of employees, in the event of the transfer of an undertaking as a going concern, have often been criticised in that they do not generally cover all possibilities to gain control, e.g. the transfer of shares.[236] It is questionable whether a Labour Court would have the opportunity to examine the sale of shares and come to the conclusion that there was in fact a sale of the business.[237] Such an approach has not been taken by the courts so far.

2.3.3.2) "Going Concern"

For the transfer of the employment contract by act of law as described in s. 197 (1)(a) of the LRA it is essential that the transfer occur as a "going concern". Neither the LRA nor the common law provided any definition for the term "going concern". The South African courts examined this

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233 Van Niekerk A, *Unfair Dismissal*, 87.

234 Van Niekerk A, *Unfair Dismissal*, 87; Smit N, *Labour Law implications of the transfer of an undertaking*, 119.

235 Smit N, *Labour Law implications of the transfer of an undertaking*, 119.

236 Smit N, The Labour Relations Act and the transfer of undertakings: The notion of a transfer (2003) *De Jure* 328, 330.

237 Van Niekerk A, *Unfair Dismissal*, 87.

term and compared it with legal sources abroad. This happened, for instance, in the Cape High Court's decision of *General Motors SA (Pty) Ltd v Besta Auto Component Manufacturing (Pty) Ltd & another,*[238] where the court examined the Australian decision to *Ferne v Wilson*. Within this decision of 1900 the "going concern" was described as follows:

> "The words 'as a going concern' are merely intended to mean that the shop is being kept open instead of being closed up, and that the customers are being kept together so that if the purchaser wishes to keep on the business he can do so;...."[239]

It was acknowledged that the business had to be open, i.e. in operation,[240] but it was unclear under what circumstances a business transfer could be considered as a transfer as a going concern. According to the South African jurisdiction, a sale of only the assets of a business is not a transfer of this business, and certainly not a transfer as a going concern.[241] *Van Niekerk* added that a transfer of assets cannot be considered a transfer as a going concern.

One of the most widely discussed problems in South African as well as in European labour law is the notion of the term *going concern*. This term was not utilised by the Labour Courts under the Labour Relations Act (1956).[242] There was no necessity to do so, because of the impossibility of applying a statutory provision which would protect employment in the event of a transfer of a business or part thereof.

Despite the fact and knowledge of the legislature that the notion of a going concern was problematic as discussed abroad, the Labour Relations Act of 1995 contains no definition of this term.

In the important case of *Schutte & others v Powerplus Performance (Pty) Ltd*[243]*),* the Labour Court argued that there had indeed been a transfer of a business as a going concern. The court stipulated, in the context of the constitutional basis of the LRA, for the application of section 197(2)(a) of the

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238 (C) in 1982 2 SA 653ff..

239 *General Motors SA (Pty) Ltd v Besta Auto Component Manufacturing (Pty) Ltd &* another (C) in 1982 2 SA 653, 657 in reference to *Ferne v Willson* in 1900 26 VLR 422 at 437.

240 *SAMWU & others v Rand Airport Management Co (Pty) Ltd & others (LAC)* in *ILJ* 2002, 306ff. para 27 with reference to other cases.

241 Van Niekerk A, *Unfair Dismissal,* 88.

242 Smit N, *Labour Law implications of the transfer of an undertaking*, 175.

243 (LC) in *ILJ* 1999, 655ff..

LRA (1995) and examined the following indicators which must be considered for the investigation of the term "as a going concern". The court made a teleological interpretation of section 197 of the LRA (1995) in respect of the decisions of European courts, especially the European Court of Justice.

The Labour Court stated

> "It is sufficient and appropriate to adopt the approach favoured by the English Courts and the European Court of Justice prior to the Dines and Schmidt decisions and reaffirmed in Betts and Suzen respectively. This requires an examination of substance and not form; weighing factors that are indicative of a Section 197 transfer against those which are not; treating previous cases as useful indicators, but not precedent, and in this way deciding what is ultimately a question of fact and degree. [5] The existence of a relationship between the Second Respondent and the First Respondent, the in- principle agreement to sell the workshops, the terms of the Working Agreement, the First Respondent's employment of the majority of the workshop employees, the use of the same premises, the continuation of the same activities without interruption and the intended transfer of assets and equipment indicate that there was a transfer of a business as a going concern within the meaning of section 197".[244]

The Labour Court used the term "economic entity" which has to be transferred as a going concern. But the court did not use the test developed by the European Court of Justice (ECJ) for the transfer of a going concern, which considers the transfer of an economic entity retaining its identity within that decision.[245] The term "going concern" refers, as mentioned above, to a business in operation. Regarding insolvent businesses, one had to recognise that these establishments are often not in operation any longer. The above-discussed terms of section 197 of the LRA were in this respect too vague.

2.3.3.3) "Rights and Obligations"

S. 197 (2)(a) of the LRA (1995) stated that all "the rights and obligations between the old employer and each employee at the time of the transfer [will] continue." But the regulation left unclear which obligations and rights were relevant and had to be transferred. It was questionable whether only agreements between transferor and employee could be subsumed under this term, or whether it also contains also special rights and obligations between the transferor and a third person.

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[244] At www.caselaw.ac.za at para. 4 and 5.

[245] This test will be shown *infra.*

Section 197 of the LRA (1995) made a distinction between the transfer of a solvent business in subsections [(1)(a), (2)(a)] and the transfer as a result of insolvency or a rescue of an undertaking in subsections [(1)(b), (2)(b)]. The biggest difference between these two mechanisms was that subsection (2)(b) of the LRA (1995) provided that

> "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, and anything done before the transfer by the old employer in respect of each employee will be considered to have been done by the old employer".

Jones stated that the legislator had good reason for this wording, because a business without any obligation towards its employees would be much more attractive to prospective buyers.[246] But according to *Wallis*, the rights and obligations between the employee and the old employer were transferred, if they formed a part of the contract of employment, whereas the restriction from section 197 (2)(b) of the LRA (1995) covers only rights and obligations with third parties.[247]

To address the conflicting opinions, it was necessary to consider the legal nature of rights and obligations in terms of section 197 of the LRA (1995). It was debatable which rights and obligations were covered by section 197 of the LRA. They could be subsumed under section 197 of the LRA (1995) if they formed part of the employment contract or – much wider – if they only arose from the relationship between old employer and employee.[248] It was also unclear whether section 197 of the LRA (1995) also covered rights and obligations, which were not covered by the relationship but arose from other contracts, delicts or statutes. The Act itself was in this regard again silent. Because of the main issue to regulate labour relations, it seemed to be clear that only these rights and obligations were transferable, which formed part of the relationship between transferor and employee.

2.3.4) General criticism of the new law

Numerous problems resulted from the wording of the regulation, because some necessary terms and phrases were not clearly defined by the Act and led to several uncertainties regarding the application of section 197 of the LRA (1995), as considered *supra.* Several problems resulted from

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[246] Jones J, *The Interpretation and Effect of section 197 of the Labour Relations Act 66 of 1995,* 84.

[247] Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 7.

[248] These options are given by directive 98/50/EC.

the legislator's fundamental approach to the transfer problems. The realization and implementation of the goals of the five-year plan led to problematic discussions regarding the new planned transfer of undertakings law. It was debatable whether a statutory provision such as section 197 of the LRA (1995) could sufficiently balance the different interests in transfer circumstances. At a first glance the Act brought much more security to the employees in cases of the transfer of undertakings, businesses or parts thereof. The great advantage was the possibility of an automatic transfer of the contracts of employment in cases of a transfer of a going concern by act of law. Due to the fact that a transfer as a result of mergers or acquisitions is often linked with a reduction of the workforce, one could at first glance think that a regulation that provides for an automatic transfer interferes with the employer's interests. But in this regard one should bear in mind that an automatic transfer could also be in favour of numerous employers. In the absence of statutory provisions for such a transfer, the employer could face difficult and also time-consuming procedural obligations, compensation orders and costly severance payments.[249] A legal framework of transfer of undertaking regulations in general facilitates the transfer, because it offers an effective mechanism that saves costs and time-consuming procedures.[250] Regarding the great number of restructuring establishments in the post-apartheid South Africa, one can especially see the great advantage for the economy brought about by this legislation.

In this regard one has to bear in mind that the protection of existing jobs could have in general a negative effect for the political aim to create more jobs. The protection of the current employees of a concerned undertaking is not the same as the creation of jobs in a general economic perspective. Greater protection for the workforce of an undertaking, which is involved in a transfer of its business, could lead to fewer possibilities for the political and social aims to create jobs. *Olivier* even denied that the stipulation of clause 92 of the Draft Bill would lead to more security for the workers regarding their employment contract, because of the possibility of avoiding its regulation.[251] Compared with the fair labour practice principle, one could conclude that also the field of transfers would be "far too wide" to be contemplated by a single statute such as the Labour Relations Act.[252]

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[249] Smit N, Should Transfer of Undertakings be statutory regulated in South Africa? (2003) *Stellenbosch LR* 205, 209.

[250] Jones J, *The Interpretation and Effect of section 197 of the Labour Relations Act 66 of 1995,* 4.

[251] Olivier MP, Transfer of Undertakings and Insolvent Employers: A Comparative Enquiry and Implications for South African Labour Law (1995) *TSAR* 737, 749.

[252] See *Landman J* in *National Entitled Workers Union v CCMA & others* in (LC) in *ILJ* 2003, 2335, 2340.

2.3.5) The general outcome for employment contracts

Did section 197 of the LRA (1995) make a major inroad into the common law regulation that the employee's contract cannot be transferred without the employee's consent. Not since slavery was abolished in the Cape on 1 December 1834 had there been such a major inroad into our common law in respect to employment. Section 197 had, in effect, introduced a form of statutory assignment without the employee's consent. The legal background of this assignment was a combination of a cession and delegation of rights and obligations. In this regard it is noteworthy that section 13 of the Constitution guarantees that no person will be subject to slavery, servitude or forced labour.

It was questionable whether section 197 (1) of the LRA (1995) allows the transfer of an employment contract without the employee's consent, or if subsection 1 provides for an automatic transfer.[253] There are several questions surrounding the stipulation of section 197 of the LRA regarding the employment contracts, i.e. the question about automatic transfer of the contract in special circumstances, or the possibility to transfer a contract without the consent of the affected persons, or the right to object to a possibly automatic transfer as well the possibility to agree with the affected persons in contrary to the legal stipulation.The very first sentence of the section required the consent of the affected employee and stated that the contract of employment might not be transferred from "one employer…to another employer…without the employee's consent". But the fundamental possibility to transfer the employment contract by act of law was really a tremendous change of the common law principles and constituted probably a breach of the employee's freedom of contract.[254]

According to *Schlemmer* and *Oelofse*, the consent of the employee would not be necessary in cases of a going concern. But does this regulation also determine the unimportance of the consent of the new owner?[255] The silence of section 197 of the LRA in this regard could lead to the consequence that the transferee would not have a choice to decide whether or not he wants to continue the employment contract. This would lead to a decrease of the new employer's freedom of contract. But the other possibility, namely that the transferee would have the opportunity to decide whether

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253 Driver G, Commercial Perspective on section 197 of the Labour Relations Act (2000) *ILJ* 9, 11.

254 This will be considered *infra.*

255 Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSAR* 559, 565.

he wants to employ the workforce or parts thereof, would be in contrast to the legislative and political attempts to protect employees from losing their livelihood.

The South African courts also entered the debate about necessity of the employee's consent[256]. In *NEHAWU v UCT,*[257] the Labour Court held as follows,

> "I do not agree that section 197 provides blanket protection of jobs when businesses are transferred. This section prohibits the transfer of employment contracts without the consent of the employees concerned. The section however provides that an employer *may* transfer employment contracts without the consent of the employees concerned where he transfers his business or part thereof as a going concern.
> […] the employees concerned have had no say in the transfer of their contracts of employment".

Mlambo J further held that

> "…s. 197 (2)(a) appears, at first glance, to provide that indeed if a business or part thereof is transferred as a going concern (in terms of section 197 (1)(a)) then all employment contracts at the time of the transfer are also *automatically* transferred….
>
> In a nutshell section 197 (1)(a) and 197 (2)(a) do not (and cannot) provide for the same thing, i.e. the transfer of a contract of employment."[258]

It is obvious that section 197 of the LRA deals in different ways with employment contract matters in circumstances where a solvent or an insolvent undertaking was transferred. It is questionable whether such a legal approach to the subject will be aligned with the constitutional basis, which provides fairness and equity for all employees.

One has to recognize that the right to equality before the law does not require that *all* persons must be treated identically in *all* circumstances.[259] In the light of the historical and sociological South African background, the employees' rights add to gainful economic activity in freedom and fairness.[260]

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[256] Smit N, *Labour Law implications of the transfer of an undertaking*, 213.

[257] (LC) in *ILJ* 1997, 1618 ff.

[258] (LC) in *ILJ* 1997, 1618, 1626.

[259] Devenish GE, *A commentary on the South African Bill of Rights*, 43-45; See also Sachs-Osterloh, *Grundgesetz*, Art. 3, para 44.

[260] Smit N, Automatic transfer of employment contracts and the power to object (2003) *TSAR* 465, 483.

2.3.6) The right to object to the transfer

A fundamental problem of section 197 LRA was the legal nature of the transfer of the employment contract, e.g. the question of whether the employees would be obliged to be transferred to the transferee or whether they would have the right to object to the transfer of their contracts.[261] *Olivier* argued that the employee would not have a right to object to the transfer. According to him, section 197 of the LRA weakened the position of the employee in the case where the employee was likely to object to the transfer, because it does not contain such a right to do so.[262] If one is of the opinion that section 197 of the LRA did not offer the employee who opposed the transfer the right to object, one can see the problem of the new regulation, bearing in mind that the consent of the employee was necessary under the common law. If South African labour law did not provide for the employee's right to object to the transfer of his employment under the LRA (1995), the abovementioned right to be protected from forced labour would nevertheless be acknowledged. Under such circumstances the employee would have the possibility to resign from working. But the right to resign can only be seen as one of several opportunities for the employee who does not want to work for the transferee.[263]

[261] Smit N, Automatic transfer of employment contracts and the power to object (2003) *TSAR* 465, 465; Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1391.

[262] See Olivier MP, Transfer of Undertakings and Insolvent Employers: Recent Developments (1996) *TSAR* 169, 169.

[263] In the cases of *Grigorios Katsikas v Angelos Konstantinidis and Uwe Skreb and Günter Schroll v PCO Stauereibetrieb Paetz & Co. Nachfolger* the European Court of Justice had to answer several questions in respect to the employee's power to object to the transfer. The European Court of Justice held,

> "31 Whilst the directive, […] allows the employee to remain in the employ of his new employer on the same conditions as were agreed with the transferor, it cannot be interpreted as obliging the employee to continue his employment relationship with the transferee.
>
> 32 Such an obligation would jeopardize the fundamental rights of the employee, who must be free to choose his employer and cannot be obliged to work for an employer whom he has not freely chosen.
>
> 33 It follows that Article 3(1) of the directive does not preclude an employee from deciding to object to the transfer of his contract of employment or employment relationship and hence deciding not to take advantage of the protection afforded him by the directive. […
>
> 35 It follows that, in the event of the employee deciding of his own accord not to continue with the contract of employment or employment relationship with the transferee, the *directive does not require the Member States to provide that the contract or relationship is to be maintained with the transferor*. In such a case, it is for the Member States to determine what the fate of the contract of employment or employment relationship should be."

(ECJ in *IRLR* 1993, 179 ff.. at para 31, 35; all italics added)

One could say that the right of the employee to resign isn't affected by section 197 LRA, because the resignation by the employee would be an alternative agreement compared to the transfer of the employment contract. If the employee terminates the contract himself, his employer would not dismiss him. This had the consequence that he would not gain any compensation for a dismissal under section 189 LRA.[264]

In circumstances where section 197 (2)(a) of the LRA (1995) was applicable, the legislature did not give the employee concerned any choice regarding the transfer of his employment contract.[265] The transfer was for that reason independent from his consent.

Wallis stated that the autonomy of the individual person would be overridden by the interests of achieving a greater collective good, because of such an automatic transfer of the employment contracts.[266] But despite the question whether this collective good is really "greater" than the individual freedom of contract, one has to keep in mind that section 197 LRA (1995) provides the possibility of agreements with alternative arrangements.

The power to object to the transfer of the employment contract should not be confused with an agreement to vary certain or all rights and obligations connected with this contract of employment. The right to object involves the rejection of the transfer of the employment contract to another employer by the affected employee, whereas a contrary agreement involves the transfer and possible amendment of rights and obligations connected to such a contract of employment that is being transferred.[267] It should nevertheless be examined whether the provisions of section 197 (2) of the LRA (1995) give the employees the power to object. Of great importance, in this regard, is the distinction between section 197 (2)(a) and (b) LRA (1995), i.e. the distinction between the transfer as a going concern of solvent and insolvent undertakings. The South African courts discussed several possibilities regarding the employees' power to object and the statutory provisions to agree in special schemes. The Labour Appeal Court said that the potential contrary agreement in section 197(2)(a) of the LRA (1995) would only be relevant to the question of whether or not the existing rights and obligations are transferred, but not to the transfer of the

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[264] Smit N, Word Werksekuriteit gewaarborg in die lig van artikle 197 van die wet op arbeitsverhoudinge 66 van 1995 (1997) *TSAR* 548, 555.

[265] *Mlambo J* in *NEHAWU v UCT & others* (LC) in *ILJ* 2000, 1618, 1626.

[266] Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 3.

[267] Smit N, *Labour Law implications of the transfer of an undertaking*, 206.

employment contract itself. Contrary to subsection (2)(a), subsections (1)(b) and (2)(b) of section 197 of the LRA would leave open the possibility that an agreement to the contrary can be reached, which would not only be in respect of the transfer of rights and obligations, but also in respect of the transfer of the employment contract itself.[268] But these subsections are not applicable to the transfer of a solvent business, because they explicitly deal with the transfer under circumstances of insolvency.[269]

Such an approach could lead to the situation where the employee who is employed by a solvent business would not have a right to object when this business is transferred as a going concern. Contrary to the aforementioned position, the employee who is employed by an insolvent employer would have such a right to object to the transfer, because of the applicability of section 197 (1)(b), (2)(b) of the LRA in such cases.

Even in cases of insolvency, a possibility to agree otherwise did not necessarily lead to an employee's power to object. These possible agreements in circumstances of section 197 (2)(b) of the LRA refer to the provision of section 197 (3) of the LRA to section 189 of the LRA. According to section 189 of the LRA, the affected parties are mutually exclusive. Bearing that in mind, in a situation where an individual employee who would like to object to the transfer of his contract according to section 197(2)(b) of the LRA, he would not be allowed to do so if the registered union had agreed to the transfer of all employment contracts. Even if one would read section 197 (2)(b) of the LRA in a manner which implies that the parties in terms of section 189(1) of the LRA are only mutually exclusive as far as an agreement to the contrary is concluded, this would still lead to a potentially undesirable situation.[270] Because of the preference for the collective agreement, the power to object would be foiled.

In the event that a union agrees not to transfer, it is possible that the individual employee who chooses not to exercise his right to object will be in the dilemma that the union's agreement enjoys preference over his choice to continue with the transferee. Section 197(1)(a) and (2)(a) of the LRA result in the transfer of employment contracts without the consent of the employees when the transferor and transferee agree and all previous rights and obligations continue.[271]

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[268] *Zondo JP* at *NEHAWU v UCT & others* (LAC) at para 81 and 88.

[269] See also at Smit N, *Labour Law implications of the transfer of an undertaking*, 232.

[270] Smit N, Automatic transfer of employment contracts and the power to object (2003) *TSAR* 465, 484.

[271] See the possibility of extending collective agreements in terms of sections 23 and 32 LRA.

A second possible and almost similar interpretation can be found in the decision of the Labour Appeal court in its case of *Foodgro v Keil.*[272] According to that interpretation, section 197(2)(b) of the LRA provided for the opportunity to exclude the transfer of the employment contract by contracting out of it, whereas section 197(2)(a) of the LRA did not offer such an opportunity. According to section 197(2)(a) of the LRA, the relevant parties may alter the terms of the transferred contract, but they cannot escape the fact that the transfer by act of law exists. No right to object is therefore recognised under section 197(2)(a) of the LRA for solvent undertakings. This allowance to contract out of the transfer can be seen under section 197(2)(b) of the LRA.

With respect to such an opportunity one should bear in mind the situation in Germany under the first version of § 613a BGB, which did not regulate a right to object to a transfer. The BAG stated that this right would be an expression of the employees' principle right, the so-called "Allgemeines Persönlichkeitsrecht" as follows from Art. 2 (1) and 1 (1) of the German Basis Law. But in Germany unlike as in South Africa, neither an agreement between a works council and the transferor (so called Betriebsvereinbarung) nor any other collective agreement can have the effect that employees are contracted out of the scope of § 613a BGB. The regulation of § 613a (1) 1 BGB is compulsory and not optional. Neither by a single bargaining agreement nor by a collective bargaining agreement would it be possible to waive the right to object to the transfer of the employment contract.[273]

In *Manning v Metro Nissan and others,*[274] the Labour Court held that section 197 2(a) of the LRA would make provision for the parties to contract out of the consequences of section 197 of the LRA by the use of the phrase "unless otherwise agreed". According to the Labour Court, this means that there should be a specific agreement between the transferor of a business, trade or undertaking as a going concern and the transferee of that business. Within this agreement, the parties must agree that the contracts of individual employees are not being transferred to the transferee of the business.[275]
These agreements can lead to a dismissal of individual employees by the transferor.[276] In such a case the transferor will be obliged to comply with the provisions of the LRA. This obligation has its reasons in the requirement that a dismissal must be procedurally as well as substantively fair.[277]

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[272] (LC) in *ILJ* 1999, 2521 ff.

[273] (BAG) in *Der Betrieb* 1975, 601, 602.

[274] (LC) in *ILJ* 1998, 1181 ff..

[275] (LC) in *ILJ* 1998, 1181 ff. at para. 43.

[276] He than would refuse his position as a transferor of the employment contract.

In summary, according to the leading opinion of South African jurisdiction, there is an automatic transfer of employment contracts in the event of the transfer of an insolvent undertaking.
But this transfer can be subject to an agreement to the contrary. This has been interpreted to imply the right to object as well. The consequences of this right to object are not currently regulated under South African law. But despite the theoretical possibility to object to the transfer, one can follow the Labour Appeal Court's decisions of *National Education Health and Allied v. University of Cape Town & others* (NEHAWU *v UCT)*[278] and *Foodgro v Keil*[279] and conclude that in South Africa the right to object only exists in cases where the transferred business is insolvent and if there is a collective agreement which could override the single employee's decision. This unsatisfactory result comes from section 197 of the LRA, no matter what interpretation is given to the effect of that law. As a last consequence, South African labour law offers the employee the possibility to resign from the transferor before the transfer. The great disadvantage of this model is that the employee will lose his protection or compensation.

It is questionable whether a differentiation between employees in solvent and insolvent businesses is in accordance with section 23 of the Constitution, which guarantees every person the right to fair labour practices. An imbalance in the treatment of the affected employees is doubtful in the constitutional context. *Landman J* held in *National Entitled Workers Union v Commission for Conciliation, Mediation & Arbitartion & others*[280] that

> "the LRA is not intended to regulate exhaustively the entire concept of a 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"[281]

Bearing that statement in mind, it could be argued that in cases where section 197 of the LRA is not able to regulate the field of balancing the different interests between the persons concerned and the employees' rights, the judiciary is called to protect the employees' right of freedom of contract.

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[277] The court did not consider that the reference to "unless otherwise agreed" in s 197(2) envisages an agreement between the transferor/transferee and one of the parties in section 189(1) LRA, which will generally be the employees or their representatives.

[278] (LAC) in *ILJ* 2002, 306 ff.; The decision of the LAC was overruled by the Constitutional Court, (CC) in *ILJ* 2003, 95 ff..

[279](LAC) in ILJ 1999, 2521 ff..

[280] (LC) in *ILJ* 2003, 2335 ff..

[281] (LC) in *ILJ* 2003, 2335, 2340.

According to *Smit*, it is rather disappointing that the Labour Court and Labour Appeal Court considered the employees' right to object to the transfer and found that no such right exists. But despite the doubts regarding the constitutional rights of employees and the ambiguous wording of section 197 of the LRA, the Constitutional Court has not had the opportunity to hear this problem.[282]

2.3.7) Transfer-related dismissals

The jurisprudence of the Industrial Court regarding unfair dismissal was one part of the field of its unfair labour practice doctrine.[283] The Industrial Court emphasised fairness towards all concerned parties in transfer circumstances. As already mentioned above, the Industrial Court utilised its unfair labour practice jurisdiction to require fair conduct towards employees in the context of business transfers.[284] The constitutional basis for the fundamental right to be protected from unfair labour practices and thus to be protected from unfair dismissals can be found in section 23 of the Constitution. In its well-known *NEHAWU v UCT*[285] decision, the Constitutional Court stated that

> "There is nothing in the nature of the right to fair labour practices to suggest that employers are not entitled to that right. Fairness is not confined to workers only. … Nor is there anything, either in the language of section 23(1) or the context in which that section occurs, which supports the narrow construction contended for by counsel. On the contrary, the context suggests that the word refers to every person and it includes both natural and juristic persons. Where the rights in the section are guaranteed to workers or employers or trade unions or employers' organisations, as the case may be, the Constitution says so explicitly. If the rights in section 23(1) were to be guaranteed to workers only, the Constitution would have said so. The basic flaw in the applicant's submission is that it assumes that all employers are juristic persons. That is not so. In addition, section 23(1) must either apply to all employers or none. It should make no difference whether they are natural or juristic persons".[286]

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[282] Smit N, Automatic transfer of employment contracts and the power to object (2003) *TSAR* 465, 487.

[283] E.g. *Gumede v Richdens (Pty) Ltd* (IC) in *ILJ* 1984, 84.

[284] As stated *supra*; Among many others: Le Roux PAK, Transferring Contracts of Employment (1996) *CLL* 11, 12.

[285] *National Education Health and Allied v. University of Cape Town & others (NEHAWU v UCT)* (CC) in *ILJ* 2003, 95 ff..

[286] (CC) at www.caselaw.co.za - at Para. 38-39.

The reason for the court's approach to the fairness principles is the purpose of the LRA (1995) to advance economic development and social justice. In this regard it is necessary to seek an appropriate balance between employer and employee.

The LRA (1995) codified numerous labour law principles developed and stipulated by the Industrial Court. These principles also covered the field of unfair dismissals. But in cases of a transfer of an undertaking section 197 of the LRA (1995) did not protect employees from dismissals linked with the transfer.[287] If the dismissal was specified for an invalid reason, this dismissal had to be considered automatically unfair. Dismissals were only fair if there was a good reason and if they came about in conformity with a fair procedure in terms of section 188 of the LRA (1995) that provided as follows:

> **"188. Other unfair dismissals**
>
> (1) A dismissal that is not automatically unfair, is unfair if the employer fails to prove-
>
> (a) that the reason for dismissal is a fair reason-
>
> (i) related to the employee's conduct or capacity; or
>
> (ii) based on the employer's operational requirements; and
>
> (b) that the dismissal was effected in accordance with a fair procedure. "

The economic needs of the concerned parties to a transfer could lead to dismissals on the grounds of operational requirements. In this respect section 189 LRA (1995) provided as follows:

> **189.Dismissals based on operational requirements.**—(1) When an employer contemplates dismissing one or more employees for reasons based on the employer's operational requirements, the employer must consult—
>
> (a) any person whom the employer is required to consult in terms of a collective agreement;
>
> (b) if there is no collective agreement that requires consultation—
>
> (i) a workplace forum, if the employees likely to be affected by the proposed dismissals are employed in a workplace in respect of which there is a workplace forum; and
>
> (ii) any registered trade union whose members are likely to be affected by the proposed dismissals;
>
> (c) if there is no workplace forum in the workplace in which the employees likely to be affected by the proposed dismissals are employed, any registered trade union whose members are likely to be affected by the proposed dismissals; or
>
> (d) if there is no such trade union, the employees likely to be affected by the proposed dismissals or their representatives nominated for that purpose.

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[287] Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 923, 937; Bosch C, Operational Requirements Dismissals and section 1997 of the Labour relations Act: Problems and Possibilities (2002) *ILJ* 941, 945; Smit N, *Labour Law implications of the transfer of an undertaking*, 326.

(2) The employer and the other consulting parties must in the consultation envisaged by subsections (1) and (3) engage in a meaningful joint consensus-seeking process and attempt to reach consensus on—

(a) appropriate measures—

(i) to avoid the dismissals;

(ii) to minimise the number of dismissals;

(iii) to change the timing of the dismissals; and

(iv) to mitigate the adverse effects of the dismissals;…"

An interpretation of the problems regarding dismissals in circumstances of a transfer of an insolvent undertaking can be seen in the following example. For dismissals based on an operational reason, section 189 of the LRA (1995) is applicable. But according to *Lombard* and *Boraine,* section 189of the LRA is not applicable in cases of sequestration or liquidation when the employment contracts will be terminated in the terms of section 38 of the Insolvency Act. Such a termination of the contract cannot be seen as a dismissal as defined in section 186 of the LRA, but nevertheless as a termination by operation of law. But if the insolvent business was transferred as a going concern, section 189 (1995) of the LRA could again be applicable when the transferee decides after the completion of the transfer to dismiss some of his employees.[288] Neither section 197 of the LRA (1995) nor the other provisions applicable to dismissal matters (chapter eight of the LRA (1995)) regulated the transfer-related or transfer-linked dismissals in a way that such a dismissal would be considered as automatically unfair. A further question was related to the possibility of dismissals prior to the transfer. The retrenchment of the whole work force in that situation, to avoid the consequences of section 197 of the LRA (1995) would lead to a contrary effect and weaken the position of the employees.[289] A problem which arose from section 197 of the LRA was thus the danger of endeavours of the transferee and the transformer to structure the transaction in a way that would avoid the application of section 197 of the LRA.[290]

The LRA of 1995 recognised only three different grounds for an employee's dismissal, i.e. the dismissals related to the conduct or capacity of the employee and the dismissal because of operational requirements. A resignation constitutes, according to this definition, in certain post-transfer circumstances a dismissal.[291] The questions which arose in this fourth category was related

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[288] Lombard S & Boraine A, Insolvency and Employees: an overview of statutory provisions (1999) *De Jure* 300, 313.

[289] Blackie W & Horwitz F, Transfer of contract of employment as a result of mergers and acquisitions (1999) *ILJ* 1387, 1405 f.

[290] Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 6.

[291] Van Niekerk A, *Unfair Dismissal,* 21.

to the general necessity of such a fourth category. In 1990 Van Niekerk SM held, in his decision of *Young & Another v Lifegro Assurance,*[292] that

> "it is trite law that a retrenchment does not in itself constitute an unfair labour practice; only when it is effected in an unreasonable or unfair manner is this the case."

Though section 188 of the LRA already allowed three grounds for dismissals, Smit required a new category of dismissals in transfer cases.[293] It was questionable whether there would be a need for a fourth category for dismissals in cases of the transfer of a business or part thereof, if one bears in mind that the courts had the opportunity to decide the cases on the basis of section 189 of the LRA and the system of unfairness as stated *supra*. It was questionable if a dismissal related to operational requirements could contain the retrenchments related to a transfer. In terms of section 213 of the LRA, the term operational requirement meant, "Requirements based on the economic, technological, structural or similar needs of an employer". This seemingly all-encompassing definition[294] could be wide enough to contain the circumstances where the transferor or transferee dismisses his employees because of the - in their opinion - too large number of employees before or after the transfer. It is questionable if this situation is so different from a transfer-related dismissal that a special category would be required.

2.3.8) Information and Consultation

Olivier was of the opinion that clause 92 of the Draft Bill did not regulate anything in regard to collective rights, information sharing and consultation.[295] The silence of clause 92 of the Draft Bill as well as of section 197 of the LRA (1995) was curious, if one remembers that the Industrial Court recommended the consultation and disclosure of information of the employees as necessary. This necessity followed the need for fair labour practices. That meant that in cases where the

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[292] (IC) in *ILJ* 1990, 1127, 1134.

[293] Smit N, *Labour Law implications of the transfer of an undertaking*, 333; Prior to the amendments of § 613a BGB, this provision already contained a special category of ground for dismissals. § 613a (4) BGB provides that any dismissal by the transferor or transferee which is linked with the transfer of a business, is void. It is not necessary that the retrenchment is the sole reason for the dismissal; only a link between transfer and reason is required. This is a protection outside and independent from the Act on Protection against Dismissals (KSchG).

[294] Boraine A & Van Eck St, The New Insolvency and Labour Legislative Package: How successful was the Integration? (2003) *ILJ* 1840, 1858.

[295] Olivier MP, Transfer of Undertakings and Insolvent Employers: A Comparative Enquiry and Implications for South African Labour Law (1995) *TSAR* 737, 747.

employer wanted to act in fairness and equity regarding the retrenchment of its employees, he was required to give the employer reasonable notice of the impending closure and to initiate consultations and that the employees should all be given sufficient – i.e. also regarding the time prior to the planned decision – notice of the intended disposition.

In the decision of *Atlantis Diesel Engines (Pty) Ltd v NUMSA*[296] the Industrial Court already stated with regard to retrenchments that a consultation should take place

> "once the possible need for retrenchment is identified and before a final decision to retrench is reached."[297]

In its judgment of *Ntuli v Hazelmore Group t/a Musgrave Nursing Home,*[298] the Industrial Court decided in 1988 that the old employer would have the obligation to consult the employees' representatives with involvement of the purchaser.[299] It is generally accepted that democracy in the workplace involves the right of employees to participate in decision-making in the workplace.[300] According to that intention, one could argue that employees always, at any rate, would have the right of disclosure of information and to consultation regarding decisions that affect them in the workplace.[301] The LRA offered registered majority unions as well as workplace forums special rights to disclosure of relevant information. An employer is required by the LRA to disclose to the union all information that its representatives need to effectively perform their function as the employees' representatives. The disclosure of information shall enable the employees' representatives to engage effectively in consultation and collective bargaining. The disclosure of information was and is the logical basis for consultation and for democracy at the plant level.

In circumstances where the employer decides to transfer "his" undertaking, a trade union or workplace forum should preferably present the interests of the employees concerned. The right to freedom of association is of great importance, because the single employee will not have sufficient knowledge about the legal and economic background of a transfer in most cases. This right was provided for and protected by section 27 of the interim Constitution and after a few amendments to section 23 of the Constitution, as mentioned above.

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296 (IC) in *ILJ* 1994, 1247 ff..

297 (IC) in *ILJ* 1994, 1247, 1252 (A).

298 (IC) in *ILJ* 1988, 709 ff..

299 (IC) in *ILJ* 1988, 709, 713.

300 See e.g. at http://www.anc.org.za/ancdocs/history/congress/sactu/wff2.htm.

301 Smit N, *Labour Law implications of the transfer of an undertaking*, 303.

The LRA tries to apply the principle of co-operation and constructive engagement at the level of the single undertaking by introducing so-called workplace forums, which are statutory forums for consultative and joint decision-making that will be elected by the undertaking's employees. Because of this legitimisation, the workplace forums can be seen as the representatives of the complete workforce. The forums have the right to consult in numerous fields as stated in the work statute listed in sections 84 and 89 of the LRA (1995).

> **"84. Specific matters for consultation**
>
> (1) Unless the matters for consultation are regulated by a collective agreement with the representative trade union, a workplace forum is entitled to be consulted by the employer about proposals relating to any of the following matters-
>
> (a) restructuring the workplace, including the introduction of new technology and new work methods;
>
> …
>
> (d) mergers and transfers of ownership in so far as they have an impact on the employees;
>
> (e) the dismissal of employees for reasons based on operational requirements; exemptions from any collective agreement or any law; …
>
> **89. Disclosure of information**
>
> (1) An employer must disclose to the workplace forum all relevant information that will allow the workplace forum to engage effectively in consultation and joint decision-making. … "

In cases of the transfer of an undertaking, these rights of disclosure of information and the legally based possibility to be consulted are of importance for the single employee as well as for his representatives. But despite the possibilities for interaction and participation in the decisions of the employer, very few workplace forums have been established. The main reason for this seems to be the suspicion of the unions that they could lose power in the workplace and at the industrial level, because of the co-optation of workers through the employer at plant level.[302] Prior to 1995 the situation of the transfer of undertakings was unsatisfactory as a result of numerous problems. The negotiation for a new job and the chance to continue working with the transferee was the responsibility of the single employee.

[302] Todd C, *Collective Bargaining Law*, 44.

The Constitution is the basis for fairness and equity for all employees. On the other hand, it is necessary to mention again that the right to equality before the law does not require that *all* persons must be treated identically in *all* circumstances.[303] The right to disclosure of information and to consultation regarding decisions was an example for such differentiation. Though these rights were generally acknowledged, the situation in circumstances where the business was insolvent or might be transferred was different. Because these matters would not only have an influence on the establishment itself, but for prospective purchasers, competitors and creditors, it was very muh in the interest of the employers to remain silent in certain circumstances. The different situations and interests should be balanced within the South African legal framework.

Section 197 of the LRA (1995) did not address the issues of consultation and disclosure of information, and did not provide for these rights in transfer circumstances. This silence of the legislature was thus much closer to the employers' interest in remaining silent on planned business actions than to the goal of strengthening democracy within labour relations. The omission to provide the employees' rights to disclosure of information in section 197 of the LRA (1995) was atypical, because disclosure of information and consultation were covered specifically in other sections, e.g. in section 189 of the LRA (1995), which dealt with dismissal for operational requirements. Also ss. 16, 84 of the LRA (1995) provided for disclosure of information under organisational rights. Section 84 (1)(d) of the LRA required, in cases where a workplace forum existed, consultation in the event of partial or total plant closures and mergers and transfers of ownership in so far as they had an impact on the employees.

Despite these stipulations, there was no right to disclosure of information and consultation in circumstances where the business might be transferred or faced with financial difficulties. It was questionable whether the above regulations were applicable to transfer and insolvency situations. According to *Smit*, this situation did not appear to be any sound reason why these rights should not be applied in the event of the transfer of an undertaking.[304]

In circumstances where the financial situation of an undertaking is so bad that insolvency threatened the business, the owner of the business has a great interest in ensuring that this information did not reach the public. A buyer of a business is not only involved in the market as a

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[303] Sachs-Osterloh, *Grundgesetz*, Art. 3, para 44; Devenish GE, *A commentary on the South African Bill of Rights*, 43-45.

[304] Smit N, *Labour Law implications of the transfer of an undertaking*, 301.

potential purchaser, but also as a competitor of the insolvent business. If the buyer would know about the actions of the employees or their representatives, he could abandon his interest in buying a business with financial problems. Furthermore, he could act in a more aggressive manner to eliminate a competitor. The rights of the employees and their representatives could have an opposite effect, i.e. the debilitation of their employer and an insecure position with regards to their own employment.

As stated *supra*, the situation for the employer is more complicated in insolvency matters than in matters where a transfer of the business is planned. Potential business partners could give up working together with such an undertaking, and banks and current partners could try to change contracts to absorb their economic risks. An emphasis on public information could weaken the undertaking. At least in insolvency matters the position of the employer seems to be in favour of an exclusion of the rights to be informed and consulted.

In each case clear statutory provisions would lead to more certainty in business matters than doubtful analogies. Bearing in mind the aims of the legislature to strengthen democracy and to create a clear legal framework, one has to conclude that a clear statutory regulation was necessary for a democratisation on the plant level.[305] Due to the fact that several employees could lose their livelihood due to management decisions linked with the transfer, statutory provisions should acknowledge and appreciate the special needs of the concerned employees.

In this respect one has to recognise the obligation of the affected persons to remain silent about the business information (business discretion). In Germany the members of the working councils are required to remain silent about the information which they receive during their work as representatives, as stated in § 79 of the Works Constitution Act (BetrVG).[306] It is questionable, though, whether or not a plain prohibition of an unauthorised disclosure by an affected member of a union or working council could guarantee that the information would not reach the public. This would be a possible way to balance the interests of employees and negotiating partners of the transfer deal.

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[305] See Smit N, *Labour Law implications of the transfer of an undertaking*, 303.

[306] In accordance with § 120 (1) Works Constitution Act (Betriebsverfassungsgesetz-BetrVG) the representative who breach this duty commit a crime and could be punished with a fine or with imprisonment up to one year. But it is debatable whether this criminal sanction could protect the interests of the transferee and potential transferor in an appropriate way if one keeps in mind the value of large industrial deals.

2.3.9) The interaction between the LRA and Insolvency Act

For the examination of the outcome of the contract of employment in circumstances where an insolvent business will be transferred, the general interplay between section 197 of the LRA and section 38 of the Insolvency Act regarding the contract of employment is of great importance.

In 1991 *Jordaan* wrote,

> "At the heart of disputes over transfers and closure lies a clash between the employer's interest in the efficiency or survival of the undertaking and the employee's interest in job security; between the employer's right to safeguard sensitive information and the employee's right to be informed at the earliest possible opportunity of changes in the structure and organisation of the enterprise; or between the employer's right to transfer the undertaking and the employee's right to freely choose his/her employer".[307]

The problems regarding these clashing interests increased after 1995 because of the fact that in numerous cases the stipulations of the LRA were not aligned with the stipulations of the Insolvency Act. According to section 197 of the LRA (1995), the contract of employment would be continued if the transfer was a going concern. It was questionable if this continuity would lead to serious consequences regarding the Insolvency Law. After the enactment of the LRA several interpretational problems arose, especially from the conflict of section 38 of the Insolvency Act and the LRA, especially section 197of the LRA.[308]

Bearing the situation prior to 1995 in mind, it becomes clear that the regulations of section 197 of the LRA (1995) (automatic transfer) and section 38 of the Insolvency Act (automatic termination of the contract) could cause several disadvantageous and probably unintentional consequences for the affected persons.

In that regard section 210 of the LRA stipulates as follows:

> "If any conflict, relating to the matters dealt with in this Act, arises between this Act and the provisions of any other law save the Constitution or any Act expressly amending this Act, the provisions of this Act will prevail."

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[307] Jordaan B, Transfer, closure and insolvency of undertakings (1991) *ILJ* 935, 935.

[308] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1846; Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSAR* 559.

Prior to an application of section 210 of the LRA, one has to consider if the regulation of section 197 LRA would be in conflict with any other provisions. If one keeps in mind that section 197 of the LRA provided for the transfer of the employment contract the possibility that this regulation could be in conflict with section 38 of the Insolvency Act and the appropriate principle of the common law cannot be excluded.

The principle of clause 92 (4) of the Draft Bill that rights and obligations were not transferred in cases of insolvency proceedings was extended by the words of section 197 (2) of the LRA, which provides for schemes of arrangement and compromises to avoid sequestration and winding up for reasons of insolvency. This scheme demands consultation with a union, the workplace forum or the employees[309]. Notwithstanding the extension and the important amendment of section 197 of the LRA compared with clause 92, the regulation was attacked from the beginning.

Because of the consequences of section 197 of the LRA (1995) in (broadly speaking) circumstances of insolvency, the accurate scope of section 197 (1)(b) of the LRA (1995) was and is of great importance. Section 197 (1)(b) of the LRA (1995) was criticised because of its uncertain and unclear wording.

Several problems arose from the very short text of subparagraph (i), as it stipulated an application of section 197 of the LRA in circumstances where the old employer is insolvent and being wound up or is being sequestrated. Because the text reads "is insolvent and being wound up or is being sequestrated", it seems to be clear that a regulation regarding a sequestration that occurs because the "perfectly solvent" corporate body is wound up either voluntary or by order of court does not fall under the scope of section 197 of the LRA.[310] On the other hand, the reference "being wound up" leads to the conclusion that the legislator could only mean, because in contrast to the natural person as the owner of the estate, only a close corporation or a company can be wound up. According to *Wallis,*[311] the reference to employers being wound up must be a reference to a legal person, i.e. a company or close corporation. Although section 344 of the Companies Act did not

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309 See Olivier MP, Transfer of Undertakings and Insolvent Employers: Recent Developments (1996) *TSAR* 169, 169.

310 Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 6.

311 Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 6.

Jones' opinion is insofar? at? vague?, if he concludes that only corporate bodies could be sequestrated (Jones J, *The Interpretation and Effect of section 197 of the Labour Relations Act 66 of 1995*, 83); See De la Rey E in *Mars - The Law of Insolvency in South Africa* (1988), 16f..

refer directly to a company being insolvent because of its cash flow, there were situations imaginable where perfectly solvent corporate bodies were wound up either voluntarily or by order of the court because of a cash flow problem. Because of the lack of a regulation in the Insolvency Act regarding the cases where a legal person is insolvent, one has to look at the special Acts regulating the matters for these legal persons. Because of the fact that neither the Companies Act 61 of 1973 nor the Close Corporations Act 69 of 1984 stipulated anything with regard to the employees' position in cases of the liquidation of a company or close corporation,[312] section 38 of the Insolvency Act is applicable *mutatis mutandis*.

Because of the aim of the LRA to protect employees[313] one should extend the scope of section 197 (1)(b) of the LRA (1995) to legal persons who are unable to pay their debts because of an ordinary cash flow problem.[314] In this regard it should not matter whether these persons are close corporations or companies. As stated *supra,* the insolvency law applies to both kinds of insolvency: the one where the company or close corporation is unable to pay its debts because of a commercial insolvency, and the other where the total liabilities of the legal person exceed the value of its assets. The intention to regulate both – the insolvencies and sequestrations of employers who conduct business in their personal capacity and insolvencies and winding-ups of legal persons – was obviously one reason for the difficulties regarding the text of section 197 (1)(b) of the LRA (1995).[315]

Uncertainties about the impact of section 197 of the LRA (1995) bear the danger to structure a transfer of a business in a way that avoided the operation of section 197 of the LRA (1995).[316] The attempt of the transferor and transferee to circumvent the stipulations of section 197 of the LRA (1995) was the main problem in the well-known cases of *Schutte & others v Powerplus Performance (Pty) Ltd & another*[317] and *Ndima & others v Waverley Blankets Ltd.*[318]

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312 Liversage A, 'n Ondersoek na die Toepassing van artikel 38 van die Insolvensiewet 24 van 1936 (1995) *SA Merc LJ* 149, 152.

313 See the decision of the LAC in the *Foodgro v Keil* case, where the court recognised that the stipulations of section 197 LRA are primarily aimed at the further protection of employees (LAC) in *ILJ* 1999, 2521 ff.. at para. 14.

314 Section 339 Companies Act and section 66 of the Close Corporations Act.

315 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1842.

316 Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 6.

317 (LC) in *BLLR* 1999, 169 ff..

Zondo J held in *Ndima*[319] that

> [75]… "[i]n real life the sale of shares in a company is used in order to gain not only control of the business but also in effect the business itself. But I also accept that the mere fact that a person buys shares in a company and thereby gains control of the company does not necessarily mean he is going to continue the same business.
>
> [76] Although I well realise that it may be very easy for employers to circumvent sec 197 if it is held that the transaction in this case did not attract sec 197, I am of the view that to hold otherwise would be to go far beyond the acceptable limit to which a Court may go in disregarding the language of a statute. I conclude therefore that in this matter the transfer of possession and control relied upon by the applicants was not enough to bring them within sec 197 and that sec 197 did not apply.
>
> [77] I am of the opinion that there is a *crying need* for an amendment of sec 197 to cover the situation such as the one, which occurred in this case. Accordingly Government, Business and Labour may do well to consider the desirability of such an amendment of sec 197. Another way to deal with the problem may be to amend sec 38 of the Insolvent Act to say upon the granting of a provisional liquidation order, existing contracts of employment are suspended pending the discharge of the rule or the granting of a final liquidation order. Upon the granting of a final liquidation order, the contracts of employment may then terminate by operation of law, or, upon the discharge of the provisional liquidation order, the suspension of contracts can be uplifted by operation of law and the contracts of employment may continue as before."[320]

Landman J in *Schutte*[321] stated the main problem and intention of section 197 of the LRA,

> "[31] Given the fundamental conflict of interest addressed by section 197 it is regrettable that its provisions are so terse. Perhaps this is inevitable since the section strikes at the very heart of that conflict and the Act, in its final form, is the product of a negotiated agreement between organised labour and capital, the representatives of the conflicting interests. The provisions of section 197 are part of the Act's mechanisms designed to provide security of employment in times of change. They give effect to the Constitutional right to fair labour practices in situations of business restructuring and reorganisation of employment and must be interpreted in this context."[322]

These statements show that the employees' protection was incomplete. The importance of resolving the questions flowing from the interplay between labour and insolvency law regulations becomes clear if one takes a brief look at a few problems arising from the distinctions and problems between the LRA and Insolvency Act.

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318 (LC) in *ILJ* 1999, 1563 ff..

319 (LC) in *ILJ* 1999, 1563 ff.

320 Italics added.

321 (LC) in *ILJ* 1999, 655 ff.

322 (LC) in *ILJ* 1999, 655 ff. at para 31.

Section 197 (2)(b) of the LRA stated that the contract would be transferred automatically.[323] It is unclear which contract shall automatically be transferred if the employment contract was terminated under the force of section 38 Insolvency Act. The persons concerned have to answer the question of how to deal with the interplay between the transfer of the contract of employment as provided in section 197 of the LRA and the payment of severance benefits provided by section 38 of the Insolvency Act. How should the situation be handled if the employer received some compensation or any other money as a result of the insolvency and the contract of employment would later be transferred to a new owner with continuing wages? It is important to examine the interplay between labour law and insolvency law regulations and to find solutions to the above questions.

2.3.10) Possible ways of resolving the disparity between section 197 of the LRA (1995) and section 38 Insolvency Act

Because of the different kinds of links between the European regulations and section 197 of the LRA, a short summary will help to explain the European approach to the conflicts between labour and insolvency law.[324] Directive 98/50/EC stipulated that the member states were allowed to exclude transfer provisions regarding individual rights under circumstances of insolvency. But the member states were expressly required to take appropriate measures to prevent misuse of insolvency proceedings in such a way that would deprive employees of the rights provided for in the Directive. That led to the conclusion that even in cases where some provisions in favour of employees were excluded, other provisions to safeguard employees' rights in the event of their employer's insolvency would remain. The possibility to exclude the employees' rights in transfer matters has to be considered within the whole legal framework of the ARD. That is why social security entitlements were guaranteed within the EU. The member states were expressly required to take appropriate measures to prevent a misuse of insolvency proceedings in such a way that would deprive employees of the rights provided for in the ARD.

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[323] Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSAR* 559, 560.

[324] The South African legislature was not able to recourse to this Directive in respect with the introduction of section 197 LRA (1995). It is just one possibility to deal with the regulations of transfers of undertakings in insolvency circumstances, that shall be examined within these paragraphs.

It is thus possible that the ARD stipulations regarding a transfer of the employment contract would not be applicable in circumstances of insolvency.[325] In respect of other methods than the ordinary liquidation of the undertaking the ECJ decided already in 1985 in *Abels v The Administrative Board of the Bedrijfsvereniging voor de Metaalindustrie en de Electrotechnische Industrie,*[326]

> "30 For all those reasons, the reply to the first question must be that article 1 (1) of council directive no 77/187 of 14 February 1977 does not apply to the transfer of an undertaking, business or part of a business where the transferor has been adjudged insolvent and the undertaking or business in question forms part of the assets of the insolvent transferor, although the member states are at liberty to apply the principles of the directive to such a transfer on their own initiative. The directive does, however, apply where an undertaking, business or part of a business is transferred to another employer in the course of a procedure such as a 'surseance van betaling'."[327]

This precedent was the basis for the judgement in *Jules Dethier Équipement SA and Jules Dassy, Sovam SPRL, in liquidation,*[328] where the court held,

> "25 It follows from that case-law that, in deciding whether the Directive applies to the transfer of an undertaking subject to an administrative or judicial procedure, the determining factor to be taken into consideration is the purpose of the procedure in question (D'Urso and Others, paragraph 26, and Spano and Others, paragraph 24). However, as the Advocate General has stated in points 31, 41 and 45 of his Opinion, account should also be taken of the form of the procedure in question, in particular in so far as it means that the undertaking continues or ceases trading, and also of the Directive's objectives. […]
>
> 32 The answer to the first question submitted for a preliminary ruling must therefore be that, on a proper construction of Article 1(1) of the Directive, the Directive applies in the event of the transfer of an undertaking which is being wound up by the court if the undertaking continues to trade."[329]

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[325] As often the German legislature decided in favour of more protection of employees' rights also in this case. That is why the sale of the insolvent business by the trustee was and is considered a transfer of an undertaking according to § 613a BGB. Due to the provision, employment contracts would be transferred by act of law. Although the Federal Labour Court of Germany (BAG) acknowledged this principle, it reduced the protection in the matters of transfers of insolvent businesses. The protection of employment and the continuity of the labour councils are guaranteed by the court. This means that the insolvency of the transferor would not have any influence on the protection of the vested right to be employed in the sense of § 613a BGB. On the other hand, a dismissed employee would not have the right to be re-engaged. Compared with the South African law, this manner to apply the ARD would lead to the situation, that section 197 LRA would provide for the continuity of employment in cases of insolvency, whereas other rights and obligations would not be under the protecting umbrella of the LRA.

[326] (ECJ) in EuGHE 1985, 469 ff.

[327] (ECJ) in EuGHE 1985, 469 ff. para 28-30.

[328] (ECJ) in EuGHE 1998 section I-1061 = *Der Betrieb* 1998, 1867-1869.

[329](ECJ) in *Der Betrieb* 1998, 1867, 1868 para 25 and 30f.

The courts have thus to examine the management goals. If the trustee has the aim to liquidate the undertaking, the ARD will not be applicable. But the transfer of the employment contract by act of law will be the consequence if the trustee tries to continue the business with the purpose to transfer the undertaking.

According to *van Tonder,* it is neither the intention of the legislator to modify the common law more than necessary nor to achieve absurd results by creating new regulations.[330] The question remains whether the different results of labour and insolvency law in respect of insolvent businesses and the position of employees are alone proof of such an absurdity. With the idea to transfer employment contacts without the employee's consent the legislature introduced absurd results into South African business law. Was it really necessary to change the law in a way that allows the transfer of the employment contracts in circumstances of the insolvency of a business?

Schlemmer and *Oelofse* argued that the afore-mentioned opinion would lead to the result that a change in legislation would only be possible if the legislator clearly shows the change of the political or social circumstances as well as his political will to change the current law.[331]

The political will behind the post-apartheid legislation was to protect employees. That is why the Constitution provided for the fundamental right to fair labour practice.[332] This fact is of great importance, because the aim of the Insolvency Act 24 of 1936 was the protection of the creditors. The intention of the current legislature in transfer of insolvent undertaking matters was to balance the interests of all parties concerned. To reach the required effectiveness it was important and necessary that the new regulations would especially be aligned with the structures of the insolvency law. It was thus of great importance that the whole legal framework which regulatet the transfer of insolvent undertakings would be consistent and, despite its complexity, not leave room for uncertainties. A balancing of these regulations by the court was possible. In the often-quoted decision, *Venter v R,*[333] the court held that a court could differ from the meanings of unequivocal and clear terms [of the Act] if these words would lead to absurdity so glaring that it could never have been contemplated by the legislature. But regarding the intention to protect the employees'

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330 Van Tonder SIE *et al, Die Uitleg van die Wette* (1981), 96 and 118.

331 Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSA*R 559, 563.

332 As already stated *supra*, the fair labour practices principle is of course also applicable to employers.

333 1907 TS 910, 914 (The Innes Labour Brief).

interests to continue with their work under the existing regulations, it is questionable if the intention of the legislature was not to breach the principles of the common law and section 38 of the Insolvency Act, where the employees' job security was very weak. But due to section 210 of the LRA, the courts' task to balance section 38 of the Insolvency Act and the stipulations of the LRA could have been minimised.

A first opportunity to resolve the above-mentioned problem is the prevailing of the Insolvency Act's provisions. Section 210 of the LRA (1995) states though that the Act will generally enjoy preference in the event of an apparent conflict between the provisions of the Act and another law.[334] The stipulations of section 38 of the Insolvency Act as well as the common law regulation, which stated that the insolvency poses a breach of the contract and that the employment contract will automatically be terminated, would be overridden by section 197 of the LRA (1995) in general.

However, the specific provisions of section 38 of the Insolvency Act and section 197 of the LRA seemed not to be resolvable by a plain denial of the Insolvency Act's regulations. The biggest problem regarding the conflict between section 197 of the LRA and section 38 of the Insolvency Act was the position of employer and employee between the termination of the contract according to section 38 of the Insolvency Act and the decision of the trustee to transfer the business as a going concern and the enforcement of section 197 of the LRA.[335] It was debatable whether the employment contracts would be terminated on liquidation or sequestration with a *later revival* of them or whether the contracts would, because of an inapplicability of section 38 of the Insolvency Act, *survive* the sequestration or liquidation proceedings.[336]

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[334] It is obvious that section 210 LRA did not only provide for the overruling of another Act in cases of conflict of that Act with a stipulation of the LRA. This could lead to the strange situation where the LRA could overrule the regulation of section 38 Insolvency Act, but not the common law rule behind that section, which stipulated that a contract of employment will be automatically terminated in cases of insolvency. In the event of conflict between section 197 of the LRA and the provision of any other law, section 197 LRA (1995) would prevail.

[335] Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSA*R 559, 561.

[336] Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSA*R 559, 561 refere to the term "herleef".

The consequence of a retroactive effect of section 197 of the LRA (1995) would be that the contract of employment would not be terminated in accordance with section 38 of the Insolvency Act, if the business would be transferred as a going concern.[337] According to that opinion, section 38 of the Insolvency Act would not influence the contract of employment in circumstances where section 197 of the LRA would be applicable. A disruption of a proper administration of liquidation would be the unfortunate result of this.[338]

But it was questionable whether this opinion could still be defended against the background of the wording of section 197 (2)(b), which in reference to certain circumstances described in section 197 (1)(b), stipulates that

> "the contracts of all employees that were in existence *immediately before* the old employer's winding-up or sequestration transfer automatically to the new employer…"[339]

At first the problem in this regard is the meaning of "immediately before". The English Court of Appeal decided, in another context, that this phrase refers to the period immediately before a transfer in *Secretary of State for Employment v Spence.*[340] It held that in cases where employees were dismissed within a time period of three hours before the transfer, one couldn't acknowledge that the employees were employed immediately before the transfer. In the Appeal Court's view, the employees are only employed immediately before the transfer if their contracts are still in existence at the time of the transfer.

In South Africa the legislature clearly differentiated between contracts in existence *immediately before* the transfer and rights and obligations *at the time* of transfer in section 197 (2)(a) of the LRA.[341] These different wordings made it clear that there had to be a difference between the date "at the time" and the date "immediately before".

Despite the uncertainties regarding the term "immediately before", the opinion which provides that section 197 of the LRA would led to other crucial consequences. How should the situation be handled where an employee received some compensation or any other money as a result of the

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337 Meskin J, *Insolvency Law and its operation in winding-up*, 5.21.10 at 5-76.

338 Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 6.

339 Emphasis added.

340 (English Court of Appeal) in *IRLR* 1986, 248.

341 Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 641, 653.

insolvency and where the contract of employment would later be transferred to a new owner? In this regard, the problems of section 197 of the LRA with the regulations of the Insolvency law led to uncertainties for the affected employers, because of the fact that they could owe the employees wages or compensation, even though they did not receive any performance from them.

Because of the uncertainty whether the creditors would decide to transfer the business during the sequestration or liquidation or not, the situation of that business was uncertain and the outcome of the employees very insecure.[342] Also for the trustee himself the situation remained uncertain. If the creditors decided to transfer the undertaking, the employees' contracts would also in most cases be transferred with continuing wages.[343] The question for the trustee, for instance, was whether he had an obligation to employ the employees and to have a counter-performance for the remuneration. This behaviour would bear the danger that the employee would work, although the contracts were already terminated because of the sequestration or liquidation.

In *SA Agricultural Plantation & Allied Workers Union v H L Hall & Sons Ltd & others*[344] *Landman J* held that, once a company was liquidated, the Labour Relations Act did not apply and the rights of parties affected by the insolvency fall to be determined exclusively by reference to the law of insolvency. He made his well-known statement that the reach of the Labour Relations Act

> "halts once insolvency enters the picture. Thereafter the law of insolvency, administered in this instance by the High Court, takes over."[345]

An application of section 210 of the LRA would not have been possible, because of the exclusion of the LRA, so there would not be a conflict with a stipulation of the LRA.

In the *SA Agricultural Plantation & Allied Workers Union v H L Hall & Sons Ltd & others*[346] the attorneys of both parties argued that the employment relationship will continue even after the liquidation of the undertaking.[347]

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342 Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSA*R 559, 561.

343 This depends of course again on the question, if the concerned persons reach a scheme regarding the employment contracts (*supra*).

344 (LC) in *ILJ* 1999, 399 ff.

345 (LC) in *ILJ* 1999, 399, para. 21, 22

346 (LC) in *ILJ* 1999, 399 ff.

347 (LC) in *ILJ* 1999, 399 at para 9.

According to Whitear-Nel this would have the consequence that the automatic transfer kept the employment contract alive[348]. But at least in respect to *Hall* this opinion is slightly confusing, because the attorneys did not explicitly argue that the employment *contracts* would be continue.[349] This opinion would have the consequence that section 38 of the Insolvency Act had been nullified by section 197 of the LRA. Although this could be in accordance with section 210 of the LRA, the effect of section 38 of the Insolvency Act becomes unclear. Because this regulation would be applicable prior to a possible transfer, the time period between the termination of the contract in accordance to section 38 of the Insolvency Act with the fiction that this contract is still alive and the actual transfer will be uncertain.

In this respect a short look at two ECJ decisions will be useful. The European Court of Justice decided in *P Bork International A/S (in liq) v Foreningen af Arbejdsledere I Danmark*[350] that the existence of a contract of employment or of an employment relationship qualifies an employee to claim protection under the Directive 77/187/EEC. It is thus noteworthy to mention that the absence of an employment contract does not exclude the employee from the protection of the ARD if he is able to show an employment relationship at the time of the transfer. Due to the social net offered by the ARD-package, employees would not be unprotected even in cases where the regulations regarding the transfer of the business would not be applicable. The purpose of the Acquired Rights Directive is according to *Landsorganisationen I Danmark v Ny Molle Kro,*[351]

> "to ensure, as far as possible, that the rights of employees are safeguarded in the event of a change of employer… [and]… … to ensure as far as possible the continuation without change of the contract of employment or the employment relationship with the transferee in order to avoid the workers concerned being placed in a less favourable position by reason of the transfer alone."[352]

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348 Whitear-Nel N, The effect of insolvency on a contract of employment (2000) *ILJ* 845, 853.

349 Papdopoulos S & Roestoff M, The effect of recent amendments to the Insolvency Act and Labour Relations Act on employment contracts – A new Era: or is it? (2004) *THRHR* 303-311; But Evans RG, new developments in insolvency and Contracts of Employment (2000) SA Merc LJ 408, 409.

350(ECJ) in *ECR* 1988, 3057ff.

351(ECJ) in *ICR* 1989, 330ff.

352(ECJ) in *ICR* 1989, 330 at para 12 and 37.

Another opportunity to resolve the interplay between the LRA (1995) and the Insolvency Act, and to balance the interests of employees and employers was the automatic revival of the employment contracts. According to *Blackman,* the automatic revival of the contracts was the best possible solution. When a winding-up order was discharged, the position is as if there had been no such order.[353] To hold otherwise would enable a company to use winding up as a weapon against its employees or their union. He further argues that section 311 of the Companies Act does not empower the Court to discharge a final winding-up order. But this power could be found in s 354(1) of the Companies Act. Where a compromise or an arrangement took place after a winding up, the winding up would have been put to an end by he order. The winding up would remain in an indefinite status.

This uncertainty was of course neither advantageous for the trustees' work nor for the sale of the business. *Blackman* pointed out,

> "From this it follows that, unless the court makes an order to the contrary, all contracts of employment terminated by the winding-up are automatically revived. Just as the director is returned to his office, so too the employee is once again employed by the company – just as if there had been no winding-up."[354]

Unless the Court made an order to the contrary, all employment contracts terminated by the winding-up would be automatically revived, just as if there had been no winding up. The very real possibility that some employees may have found employment elsewhere was not a bar to such a finding, as the Court could make an order staying or setting aside the proceedings "on such terms and conditions as the Court may deem fit" (section 354(1)). Nothing prevented the Court from making it a term of the discharge that employees whose contracts were revived may elect whether or not to remain in employment.[355]

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[353] This occurs of course only if the Court does not order otherwise.

[354] Blackman M, The employee and the insolvent company (1993) *ILJ* 562, 564.

[355] Blackman M, The employee and the insolvent company (1993) *ILJ* 562, 564.

2.4) Conclusion of Chapter Two

Subsections 197(1)(b) and (2)(b) of the LRA (1995) regulate the transfer of insolvent undertakings and endeavoured to achieve a compromise between the interests of the affected stakeholders. But such an approach was not foreseen within the framework of South African insolvency law, which still provided for the liquidation of the insolvent business in favour of the creditors. But the provisions of South Africa labour law provided for the application of the transfer provisions in cases where a company was insolvent. Notwithstanding that principle, the transfer and continuity of acquired rights were restricted. Only the employment contract and not the surrounding rights and obligations were transferred. This was also the German method to reach a balance between the different interests.

It was thus possible to treat employees of insolvent and solvent undertakings differently in the event of the transfer of such undertakings. This made it difficult to reach a high quality of protection of the employees so that they would not lose their livelihood. The different statutory provisions that dealt with the transfer of a business had resulted in a great number of problems and uncertainties.

The corrective organ for such problems – the judiciary – was not able to resolve these problems. A clear guideline was not distinguishable in numerous cases in this field of business law.

Several problems were considered important in cases of the transfer of an insolvent business. Difficulties arose from the fundamental problem to balance the clashing interests of the affected stakeholders within the constitutional framework. The new regulations had to resolve the old national problems of small wages for the majority of South African employees and high unemployment as well as the problems flowing from worldwide economic developments. Because of ad-hoc legislation and the enormous complexity of this field, the South African legislature failed to reach its aims. One could detect such a clear line prior to 1994. Until 1995 *all* contracts of employment came to an end in *all* insolvency matters. In particular, the clashing provisions of section 38 of the Insolvency Act and section 197 of the LRA needed to be amended, because a clear and precise legal basis was necessary to reach the political aim.

3) Chapter Three – Situation after 2002[356]

3.1) The South African Labour Law after 2002

> "I believe that as a package, these amendments will send a clear signal to local and foreign investors that we are seeking to create a labour market that is efficient and that is stable. Stability will only happen if labour market regulation appropriately balances the need of enterprises to operative [sic!] efficiently and profitably and the needs of workers for protection. This is what we have sought to achieve. … In the context of high unemployment, large numbers of retrenchments and high levels of insolvency, I believe that it is important to provide certainty to employers and employees as to their rights and obligations in such circumstances."[357]

Mr Mdladlana stated the need to amend the previous statutory provisions. He gave this address during the release of the package of the Labour Relations Amendment Bill, the Basic Conditions of Employment Amendment Bill and the Insolvency Amendment Bill.

A big step forward to achieve this aim was the review of section 197 of the LRA (1995), i.e. the amendment of section 197 of the LRA (1995) and the implementation of completely new sections 197A and 197B of the LRA (2002), which regulate the transfer of a business. On 1st August 2002 the Labour Relations Amendment Act 12 of 2002 came into effect. According to its preamble, the amended provisions would clarify the transfer of employment contracts in the case of a transfer of a business, trade or undertaking as a going concern. For a better applicability of section 197A of the LRA (2002) and to solve the problems with the previous versions of section 197 of the LRA, section 38 of the Insolvency Act was subject to these amendments too.

In August 1999 COSATU, in accordance with section 77 (1)(b) of the LRA, gave notice to NEDLAC that it intended to commence with protest actions because of the unsatisfactory situation in insolvency matters and the financial insecurity for the concerned employees. COSATU demanded a review of the insolvency law. An amended Act thus had to ensure that the termination of the employment contracts by operation of law upon sequestration would not relieve the employer, trustee or liquidator from compliance with the LRA and Basic Conditions of Employment Act (BCEA). Workers who were dismissed because of sequestration or liquidation should, according to COSATU, still be entitled to severance pay. Regarding their wages and other

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356 The thesis examined cases and articles published until autumn 2005.

357 The Minister of labour's speech of the 26 July 2000 can be found at: http://www.info.gov.za/speeches/2000/000727110p1004.htm.

benefits, employees should be ranked above other secured creditors. Finally, unions and employees should be informed in a timely manner in cases where the business experienced financial difficulties that might possibly result in sequestration or liquidation. According to COSATU's opinion, the employer must have consulted with a union which represents the employees and with his workers in accordance with section 189 of the LRA.[358]

The legislature aimed to advance economic development, social justice, labour peace and the democratisation of the workplace. Due to the above-described problems and uncertainties, numerous authors[359] and South African courts[360] pleaded for an amendment of section 38 Insolvency Act as well as of section 197 of the LRA (1995). In particular, the matter of the transfer of an insolvent undertaking and the unsatisfactory way of dealing with dismissals had to be changed. The process of legislating led thus to a whole package of regulations. This package contained changes to the LRA, the Insolvency Act and the BCEA. In this regard, it was necessary to find a reconciliation of the interests of employer and employee. The legal basis for this balancing of interests was still section 23 of the Constitution. In the *NEHAWU*[361] decision the Constitutional Court held that the nature of this constitutional right of fair labour practice does not suggest that only employees are entitled to this right. It argued,

> "[t]he focus of section 23(1) is, broadly speaking, the relationship between the worker and the employer and the continuation of that relationship on terms that are fair to both. In giving content to that right, it is important to bear in mind the tension between the interests of the workers and the interests of the employers which is inherent in labour relations. Care must therefore be taken to accommodate, where possible, these interests so as to arrive at the balance required by the concept of fair labour practices."[362]

According to *Boraine* and *van Eck,* one has heed these principles if one tries to evaluate the balance between the employers' and the employees' interests (flowing out of the implementation of section 197A of the LRA).[363]

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358 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1840.

359 E.g. Lombard S & Boraine A, Insolvency and Employees: an overview of statutory provisions (1999) *De Jure* 300, 314; Schlemmer EC & Oelofse AN, Konflik tussen die Wet op Arbeidsverhoudinge en die Insolvensiewet (1996) *TSAR* 559, 568.

360 E.g. *Zondo J* at *Ndima* - (LC) in *ILJ* 1999, 1563 at paragraph 76.

361 (CC) in *ILJ* 2003, 95 ff..

362 (CC) in *ILJ* 2003, 95, 113.

363 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1856.

3.2) The South African Insolvency Law after 2002

3.2.1) The amendments to the Insolvency Act

The problems regarding the interplay between labour and insolvency law as well as social and economic needs led to the need for amendments to the South African insolvency law as well. Already in the summer of 1996, thus prior to the above-mentioned actions of COSATU, the South African Law Commission published the first Draft Insolvency Bill and Explanatory Memorandum. In 1999 a second Draft Insolvency Bill followed the first one.[364] During this legislating process important changes occurred. The South African law commission, in its 1996 Draft Insolvency Bill and Explanatory Memorandum, named the commercial community in general as the major stakeholders in circumstances of insolvency. According to this opinion, the commercial community consists not only of creditors, but also of insolvent debtors, insolvency practitioners and the government. The intention of the legislature was thus to balance the interests of *all* parties concerned. The pure protection of creditors should thus be overruled by the protection of all stakeholders including the employees concerned.

The Insolvency Amendment Act finally came into effect on 1 January 2003. The Explanatory Memorandum to the Insolvency Amendment Bill identified two main problems of the insolvency law.[365] These problems were the termination of the contract of employment on the sequestration or liquidation of the insolvent employer according to section 38 of the Insolvency Act and the gaps in the South African insolvency law in respect to disclosure of information to trade unions or employees in insolvency matters. As pointed out above, numerous problems resulted from the incompatibility of section 197 of the LRA with section 38 of the Insolvency Act. A resolution of these problems was essential to reach the legislative aims. In order to reach the political aims it was thus necessary that the new regulations should be aligned with the structures of the insolvency law on the one side, and with the provisions of labour law (s. 197 ff. of the LRA) on the other side. This corresponds with the principle that new legislative regulations shall be interpreted in a way that there is no deeper infringement of the already existing acts than necessary to reach the legislature's political intentions.[366]

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[364] See also Evans RG, New Developments in Insolvency and Contracts of Employment (2000) *SA Merc LJ* 109ff.

[365] Government Gazette, 27.07.2001, Notice R756, GG 21407.

[366] See Van Tonder SIE *et al, Die Uitleg van die Wette* (1981), 96 and 118.

3.2.2) The consequences for the employment contract

The previous section 38 of the Insolvency Act provided for the automatic termination of the contract of employment. In accordance with the decision of *Consolidated Caterers Ltd v Patterson NO,*[367] the aim of the insolvency proceedings under the previous Insolvency Act was solely the winding up of the business and not the profit making of the undertaking. It was thus not necessary to employ the workforce further.

In *Ndima & others v Waverley Blankets Ltd,*[368] the Labour Court suggested that section 38 of the Insolvency Act should be amended in a way that the new regulation shall provide for a suspension of the employment contracts rather than for their termination. *Zondo J* stated in this regard,

> "Another way to deal with the problem may be to amend sec 38 of the Insolvent Act to say upon the granting of a provisional liquidation order, existing contracts of employment are suspended pending the discharge of the rule or the granting of a final liquidation order. Upon the granting of a final liquidation order, the contracts of employment may then terminate by operation of law, or, upon the discharge of the provisional liquidation order, the suspension of contracts can be uplifted by operation of law and the contracts of employment may continue as before."[369]

The Labour Appeal Court stated in 2001 in *National Union of Leather Workers v Barnard & Perry No & another*[370] that the termination of contracts based on a special resolution of the creditors to wind up the insolvent company or other corporate entities is a dismissal as defined by section 186 (a) of the LRA,[371] which stipulates,

> "Dismissal" means that-
> (a) an employer has terminated a contract of employment with or without notice."

Once this managerial resolution had been registered, the voluntary winding up commenced and section 38 of the Insolvency Act came into play, which led to the termination of employment contracts.[372] This termination was problematic because of the lack of regulations to protect

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367 1960 (4) SA 194.

368 (LC) in *ILJ* 1999, 1563 ff..

369 (LC) in *ILJ* 1999, 1563 at paragraph 76.

370 (LAC) in *ILJ* 2001, 2290 ff..

371 (LAC) in *ILJ* 2001, 2290, 2298; - section 186 (a) had to be read with 213 LRA (1995).

372 (LAC) in *ILJ* 2001, 2290, 2297.

employees. As considered *supra*, there were no provisions for the right against unfair dismissals and no right to claim severance pay. This failure of protective measures made the termination by virtue of law disadvantageous for the employees.[373]

The legislature had implemented various suggestions into the new text of section 38 of the Insolvency Act. According to the amended section 38 of the Insolvency Act, the employment contract will be suspended, rather than terminated, until the outcome of the administration of the insolvent business becomes clear.

The current section 38 of the Insolvency Act stipulates, in its first subsection, that

> "(1) The contracts of service of employees whose employer has been sequestrated are suspended with effect from the date of the granting of a sequestration order."

The suspension becomes effective upon the date of the commencement of the sequestration or liquidation of the insolvent employer. According to section 38 (2) of the Insolvency Act, the employees are not required to offer their services in terms of the suspended contract. On the other side, the trustee or liquidator of the business does not have an obligation to pay the employees' wages following their suspended contracts. For a better protection of the workers, the Unemployment Insurance Act reference allows their registration for unemployment benefits.

Under the current insolvency law, the trustee is entitled to carry on the business as a whole or in parts of the business, if the creditors authorise him to do so.[374] In cases of the absence of the creditors' authorisation, the Master of the High Court can authorise him. The business is intended to be carried on on a cash basis, i.e. to purchase for cash only and only for the taking of this business any goods that he needs for its purposes.[375] However, if the trustee trades at a loss, he has to inform the creditors and cease the trade immediately, unless the creditors direct otherwise.

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373 Boraine A & Van Eck S, The new insolvency and labour legislative package: How successful was the integration? (2003) *ILJ* 1840, 1847.

374 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1844.

375 De la Rey E in *Mars - The Law of Insolvency in South Africa* (1988), 268.

It is difficult to resolve the situation where the creditors fail to give the trustee any directions during the second meeting. According to *de la Rey's* opinion, he must take immediate steps to sell the business as a going concern.[376]

The new package addresses some of these problems. Under the current statutory law, the termination is the result of the trustee's decision and only if he fails to decide in this regard will there be an automatic termination. This was a tremendous change between the old and new section 38 of the Insolvency Act. The South African legislature modified section 38 of the Insolvency Act in a way that meant this regulation was out of line with the rest of the insolvency law stipulations.

One has to keep in mind the provisional character of the suspension. The question about the possibilities for the time after the suspension period, i.e. the rights of the final trustee regarding the employment contracts, is answered in section 38 (4) of the Insolvency Act. According to section 38 (4) of the Insolvency Act,

> "A trustee appointed in terms of section 56, or a liquidator appointed in terms of section 375 of the Companies Act, 1973 (Act No. 61 of 1973), or a liquidator who, in terms of section 73 of the Close Corporations Act, 1984 (Act No. 69 of 1983), remains in office after the first meeting and a co-liquidator, if any, appointed by the Master may terminate the contracts of service of employees, […]."[377]

After the initial suspension of the employment contracts, the new section 38 of the Insolvency Act offers different possibilities for the termination of these contracts. According to *Boraine* and *van Eck,* the final trustee or liquidator may not terminate the contracts of services unless a period of 21 days has expired. This period starts with the date of the final appointment of the final trustee or liquidator.[378] The necessity to wait for proposals of the employees and to respond to these proposals could lead to an extension of the period. The legislature gives the final trustee or liquidator a discretion regarding the termination. If one keeps in mind the above-mentioned possibilities of rescue proceedings, it is obvious that the legislation tries to strengthen job security, while offering the trustee different possibilities.

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[376] De la Rey E in *Mars - The Law of Insolvency in South Africa* (1988), 268.

[377] Emphasis added.

[378] Boraine A & Van Eck S, The New Insolvency and labour legislative package: How successful was the Integration? (2003) *ILJ* 1840, 1850.

It is questionable whether it would be useful or even necessary for the concerned parties to negotiate and finally agree to the continuity of the contracts of services. Nevertheless, section 38 of the Insolvency Act does not force the parties concerned to negotiate on a continuity of the contracts during the initial 21-day suspension.[379]

Section 38 of the Insolvency Act offers in subsection 9 a second opportunity for a termination, with the automatic termination by operation of law as follows:

> "Unless the trustee or liquidator and an employee have agreed on continued employment of the employee in view of measures contemplated in subsection (6), all suspended contracts of service shall terminate 45 days after-
> (a) the date of the appointment of a trustee in terms of section 56; or
> (b) the date of the appointment of a liquidator in terms of section 375 of the Companies Act. 1973; or
> (c) the date of the appointment of a co-liquidator in terms of section 74 of the Close Corporations Act, 1984, or if a co-liquidator is not appointed, the date of the conclusion of the first meeting."

The problem that arises from this provision is that the limited time to act could run out without any useful and tangible result. If the trustee of liquidator is unwilling to take any risks regarding the rescue of the business and continuation of the employment contracts of its workforce, the 45-day period could run out without any useful result to rescue the business.

The new section 38 of the Insolvency Act provides for an automatic termination after the initial suspension and for a termination by operation of law. The interplay between suspension and termination could encourage some employers to terminate all contracts or to dismantle the business with the intention to sell the business piecemeal. Nevertheless, such a sale could protect some employees from losing their jobs, whereas a failed transfer of the whole business would lead to the winding up of the company and termination of all jobs. With the implementation of the period of suspension, the legislature thus introduced a new rescue philosophy to section 38 of the Insolvency Act.

The amendments, however, also created a new set of problems. The period between the effective date of the sequestration or liquidation and the appointment of the final trustee is a very problematic time in respect of the rescue of the business.

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[379] Jones J, *The Interpretation and Effect of section 197 of the Labour Relations Act 66 of 1995*, 89.

Under the previous section 38, the employer had the possibility to ignore the employees' interests. Now section 38 of the Insolvency Act requires the employer to engage in consultations with employees or their representatives. This duty and responsibility could discourage the provisional trustee from running the business as a going concern. Long-lasting consultations could lead to a deceleration of the negotiations with potential buyers. However, such an intention of the provisional trustee would be aligned with the insolvency framework. In this regard, one has to keep in mind that the provisional trustee does not have any statutory right regarding the contracts of employment in the context of section 38 of the Insolvency Act. If he wants to close the business, this lack of power would cause no problems. However, if the provisional trustee has the intention to continue the business and sell it for the best possible price and to preserve jobs, he should have the right to act regarding the employment contracts within his plan to run the business as successfully as possible. This includes the power of the provisional trustee to run the business as a going concern even under adverse conditions.[380] Such regulations could finally have the consequence that the business would not be able to make a profit. A worst-case scenario could disable the trustee from finding a purchaser for the business. This regulation of the provisional trustee's administration could finally lead to a loss of jobs.

Another problem concerns the relationship between the trustee or liquidator and these workers, whose service is required in order to keep the business going. The need to employ suspended workers results from the fact that some unfinished business must be finalised. Above all, it is necessary to keep the business running to make improvements for purchase negotiations. It is questionable if it would be possible to abandon the suspension of the core employees under such circumstances. It could be in their interests if the trustee or liquidator would offer these core workers separate fixed-term contracts.

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[380] Boraine A & Van Eck S, The New Insolvency and labour legislative package: How successful was the integration? (2003) *ILJ* 1840, 1861.

3.3) The Transfer of Undertakings after 2002

3.3.1) Problems with the wording of the new regulations

One major problem under section 197 of the LRA (1995) was the unclear wording of this regulation. These uncertainties had a negative effect for the parties concerned in a transfer. According to *Le Roux*, section 197 of the LRA (1995) was far from clear in its scope and potential effect.[381] Even the Minister of Labour said,

> "that it is important to provide certainty to employers and employees as to their rights and obligations in such circumstances".[382]

The Minister makes clear that the legislation had acknowledged the criticism of the unclear wording and uncertainties of section 197 of the LRA (1995).

3.3.1.1) The scopes of Section 197 A (1)(a) and (b) of the LRA (2002)

If one compares section 197 (1)(b) of the LRA (1995) with section 197A (1) of the LRA[383] that regulates the transfer of employment contracts in insolvent circumstances, some changes to the text are evident. Section 197 (1)(b)(i) of the LRA (1995) provided:

> "if the old employer is insolvent and being wound-up or is being sequestrated…"[384]

The amended section 197A (1)(a) of the LRA provided for the transfer

> "if the old employer is insolvent;…."

The first regulation led to several uncertainties. Section 197(1)(b)(i) of the LRA (1995) referred to the old employer that "is insolvent and being wound-up". The reference to the employer being wound up seems to be a reference to a company or close corporation that is unable to pay its debts.

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381 Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) CLL 61, 61.

382 http://www.info.gov.za/speeches/2000/000727110p1004.htm; Emphasis added.

383 Due to the remarkable length the text of the sections 197, 197A and 197B Labour Relations Act (2002) and the text of the section 38 Insolvency Act (2003) will be find infra at the Annexure. – Following sections of the LRA without the annexed year 1956 or 1995 refer always to the versions of 2002.

384 Emphasis added.

However, section 344 of the Companies Act does not refer to a company being insolvent and, unusual as it may seem, there are situations in which perfectly solvent corporate bodies are wound up either voluntarily or by order of the court. The desire to use plain English in section 197 of the LRA merely caused confusion.[385]

With the new text the legislature tried to resolve the uncertainties of the old regulation, while using an all-comprehensive term to bring all above-mentioned possibilities of being insolvent under the scope of the LRA. The broader wording "is insolvent" could resolve the former uncertainties.

The text of section 197 (1)(b)(ii) of the LRA (1995) remained unchanged in the new section 197A (1)(b) of the LRA and refers to transfers of a business

> "if a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency."

A new problem with the wording of section 197A (1)(b) of the LRA comes from the passage, "*to avoid* winding-up or sequestration for reasons of insolvency"[386]. The question arises whether such a scheme would be limited to the period prior to effective date.[387] A liberal interpretation could come to the conclusion that also the period after the effective date would be contained by section 197A (1)(b) of the LRA.[388] However, the wording of this paragraph does not lead to a clear answer to that question. In this regard, one has to keep in mind that the effective date is surely not the end of any rescue procedures. Trustees often facilitate such schemes of arrangements and compromises after the effective date. It would not be appropriate to exclude such schemes from the scope of section 197A of the LRA. The protection of the employees should not depend on the effective date. The teleological explanation of the wording of section 197A (1)(b) of the LRA is in favour of a more liberal interpretation, which includes the post-sequestration and winding-up phase as well.

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385 Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 6.

386 Italics added.

387 As stated *supra*, the "effective date" is broadly spoken the date of the provisional sequestration order in the case of compulsory sequestration and the date of the sequestration order in the case of voluntary surrender.

388 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1864.

Remarkably enough, such schemes often lead to a share of sales. Nevertheless, sections 197 ff. of the LRA exclude such transfers from its application as stated *supra*. *Zondo J* pointed out that there is a "crying need" to amend section 197 of the LRA (1995) in order to extend the protection of employees where shares are transferred.[389] But section 197A (1)(b) of the LRA did not resolve the problems with share deals. According to *Boraine* and *van Eck,* this paragraph was thus poorly drafted.[390]

The wording "immediately before" in section 197A (2)(a) of the LRA (2002) is similar to the text of section 197 of the LRA (1995). The legislator did not make clear that it would prefer a broader interpretation of this wording than prior to 2002. That is why, there are no reasons to interpret the text of the current section in a different way, than the previous version. A strict interpretation as "very closely in space or time" or "directly, and without anyone or anything in between"[391] will lead to more certainty as mentioned *supra*.

3.3.1.2) "Services"

The LRA (1995) only included the matters of transfers of the whole or any part of a business, trade or undertaking and thus excluded several outsourcing operations from its scope. With respect to the outsourcing of non-core activities, one could argue that these activities are neither a whole nor parts of a business, trade or undertaking.[392] For instance, in the decision to *SAMWU & others v Rand Airport Management Co (Pty) Ltd & others*[393] the LAC rejected that garden services could be viewed as part of a business.

The court held in respect to the going concern question that,

> (a) the gardening functions form part of maintenance services;
>
> (b) these services form part of the non-core activities of Rand Airport;
>
> (c) Rand Airport outsourced the garden functions to Turnkey.[…]

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389 *Ndima* (LC) in *ILJ* 1999, 1563, 1579.

390 Boraine A & Van Eck S, The New Insolvency and labour legislative package: How successful was the integration? (2003) *ILJ* 1840, 1864.

391 Todd C *et al, Business Transfers and Employment Rights in South Africa*, 135, refer in this matter to Encarta ® World English Dictionary © & (P) Microsoft Corporation; a examination of the term can be found *supra* in chapter two of this thesis.

392 The question whether a contracting out, resp. outsourcing could be applied under section 197 LRA (1995) was the kernel of the decisions to *NEHAWU v UCT* of LC, LAC and CC

393 (LAC) in *ILJ* 2002, 306 ff..

> (d) Rand Airport and Turnkey, on their version, which must be accepted, did not intend to transfer the applicants working in the gardens;
> (e) Gardening services is not an entity. It has no separate management structure, no own goals, no assets, no customers and no goodwill. It is merely an activity and will be such in the hands of Turnkey. It is not intended to make a profit or gain some other advantage;
> (f) The gardening function is being outsourced for a limited period.[394]

The link between the question of the "going concern" and the kind of business of the transferred subject is obvious. Prior to that decision, but with respect to the examined definition problems, the amended section 197 (1)(a) of the LRA (2002) states that

> "'business' includes the whole or a part of any business, trade, undertaking or *service*."[395]

It is debatable whether outsourcing activities will fall under section 197 of the LRA (2002) and thus lead to the transfer of the employment contracts. Employers typically use outsourcing models to divest themselves of non-core activities and to save labour costs. If section 197 would be applicable in such outsourcing, these costs will simply be passed on to another party. Outsourcing will lose its position as a business alternative and employers could increasingly resort to temporary or part-time labour, or even closures. Section 197 would fail to reach an advantageous effect for the employees.[396]

Although it is not sure that the legislation had an intention to do so,[397] an expansion of the text of section 197 of the LRA with the term *service* could offer a possibility to typify outsourcing activities as going concern transfers. It is furthermore questionable whether the implication of the term "service" successfully changed the scope of section 197 of the LRA.[398]

In *NUMSA v Staman Automatic CC & another*[399] *Landman J* held,

> "The amendment to section 197 has not changed the general purpose of this section. It is aimed rather at clarification."[400]

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394 (LAC) in *ILJ* 2002, 306 ff para 34.

395 This amendment was prompted by initiative of COSATU.

396 Van Niekerk A, *Presentation outline: Outsourcing and transfer of undertakings* (Labour Law Conference 2003).

397 Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) *CLL* 61, 64.

398 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.

399 (LC) in *BLLR* 2003 1167 ff..

400 (LC) in *BLLR* 2003 1167, 1172.

Even under section 197 of the LRA (1995) the Labour Court was prepared to hold that an outsourcing transaction constitutes a transfer in the term of section 197. In *NEHAWU*[401]*, Mlambo J* stated,

> "In this regard it is possible that some outsourcing exercise could be of a permanent nature, and this type could amount a transfer of a business."[402]

The LRA does not define the term "service". For a definition of the term "business" the term "service" will not be helpful at all, because the reference to "service" will lead to new uncertainties. It is remarkable that the term "business" shall include "(the whole or a part of any) business", because it is impossible to define one term by the use of this term.

Zondo JP stated in *SAMWU v Rand Airport Management Company (Pty) Ltd.,*[403]

> "Section 197 was amended pursuant to Act 12 of 2002. Of particular relevance to the present dispute is the amendment, which introduced the concept of 'service' into the definition of 'business' and, hence, of 'transfer' as contained in section 197(1) of the Act. … Although not defined in the Act, the common meaning of 'service' as set out in the new Shorter Oxford English Dictionary is 'The provision of a facility to meet the needs or for the use of a person or a person's interest or advantage; assistance or benefit provided to someone by a person or thing; an act of helping or benefiting another; an instance of beneficial, useful or friendly actions; the action of serving, helping or benefiting another; behaviour conducive to the welfare or advantage of another; friendly or professional assistance."[404]

However, the extension by the term "services" does not lead to the point that outsourcing activities could be considered as transfers of businesses as going concerns.[405] The critical point concerning an outsourcing activity is not only whether the outsourced object would be a business, but primarily whether the transfer occurred as a *going concern*.

3.3.1.3) "As a going concern"

The concept of a business as a going concern has been the subject of debate since its introduction, as already considered *supra*. Only in a few cases have South African courts decided about the meaning and scope of the concept of a transfer as a "going concern". But in this regard it is necessary to mention that it is often hardly possible for the courts to decide which fact one has to

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401 (LC) in *ILJ* 2000, 1618 ff..

402 (LC) in *ILJ* 2000, 1618, 1632.

403 (LAC) in *ILJ* 2002, 306 ff..

404 (LAC) in *ILJ* 2002, 306 ff. Davis, para. 17

405 Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) *CLL* 61, 64.

subsume under which terms of section 197. In transfer matters the terms "services", "transfer" and first of all "going concern" often has to be proved by the same facts. Because of the fact that South African courts often referred to the jurisdiction of the ECJ with respect to the tests of the applicability of the statutory provisions, the struggle of the ECJ to deal with the term "going concern" shall be examined in more detail.

One of the most discussed problems is the concept of transfers "of an economic entity that retains its identity".[406] In the decision of *J.M.A. Spijker v Gebroeders Benedik Abbatoir CV and Alfred Benedik en Zonen BV*[407] the European Court of Justice followed the arguments of the United Kingdom Government and the European Commission. They said that in this respect the essential criterion is whether the transferee is put in possession of "a going concern" and is able to continue its activities.[408] The European concept thus raises the same questions as the concept of a transfer "as a going concern".

It is thus questionable under what circumstances an economic entity retains its identity. In its well-known *Christel Schmidt* decision[409], the European Court of Justice argued that there might be a relevant transfer in the sense of the ARD, even though only one employee is affected. The Labour Court of the second instance asked the European Court of Justice to make a preliminary ruling based on the following two questions:

> "1.) Could an undertaking's cleaning operations, if they are transferred by contract to a different firm, be treated as part of a business within the meaning of Directive 77/187/EEC?
> 2.) If the answer to Question 1 is in principle in the affirmative, does that also apply if prior to the transfer the cleaning operations were performed by a single employee?"

According to the German government, the concept of an economic entity used in the jurisprudence of the European Court of Justice is used to summarise the three concepts of an undertaking, business or part of a business within the meaning of the ARD; the concept implies that a defined economic objective is pursued in the context of an autonomous organisation that may be part of a larger one. The German government suggested that the European Court of Justice would not treat the undertaking's cleaning operation in these matters as a part of a business

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406 Although the first important decisions of the ECJ date back to the 1980s, this subject will be considered within this chapter because of the changes during recent years.

407 (ECJ) No. 24/85, IELL, Case Law, No. 88.

408 Blanpain R & Engels C, *European Labour Law*, para 507.

409 *Schmidt v Spar- und Leihkasse der Früheren Ämter Bordesholm, Kiel und Cronshagen* (ECJ) in *ECR*, 1994, 1311ff.

in the sense of the ARD. The government of the United Kingdom stated that the fact that an undertaking ceases an activity, such as the cleaning of its own premises, and instead pays another undertaking to provide that service, does not in itself constitute the transfer of an undertaking, business or part of a business.The reference of the European Court of Justice to the Higher Labour Court of Schleswig-Holstein was surprising for the governments concerned and the major opinion authors. The European Court of Justice reflected the basic principles behind the ARD,

> "Article 1(1) of Council Directive 77/187 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses is to be interpreted as covering a situation in which an undertaking entrusts by contract to another undertaking the responsibility for carrying out cleaning operations which it previously performed itself, even though, prior to the transfer, such work was carried out by a single employee."[410]

Regarding the problem of the transfer of an economic entity, the European Court of Justice stated as follows,

> "Neither the fact that such a transfer relates only to an ancillary activity of the transferor not necessarily connected with its objects, nor the fact that it is not accompanied by any transfer of tangible assets, nor the number of employees concerned is capable of exempting such an operation from the scope of the directive since the decisive criterion for establishing whether there is a transfer for the purposes of that directive is whether the business in question retains its identity, as indicated in particular by the actual continuation or resumption by the new employer of the same or similar activities."
>
> According to the case-law of the Court (judgment in Case C-209/91 *Watson Rask and Christensen v ISS Kantineservice* [1992] *ECR* I-5755, at paragraph 15), the directive is applicable where, following a legal transfer or merger, there is a change in the legal or natural person who is responsible for carrying on the business and who by virtue of that fact incurs the obligations of an employer vis-à-vis the employees of the undertaking, regardless of whether or not ownership of the undertaking is transferred.
>
> The decisive criterion for establishing, whether there is a transfer for the purposes of the directive is whether the business in question retains its identity. According to that case law, the retention of that identity is indicated inter alia by the actual continuation or resumption by the new employer of the same or similar activities. Thus, in this case, where all the relevant information is contained in the order for reference, the similarity in the cleaning work performed before and after the transfer, which is reflected, moreover, in the offer to re-engage the employee in question, is typical of an operation which comes within the scope of the directive and which gives the employee whose activity has been transferred the protection afforded to him by that directive."[411]

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[410] At para 20.

[411] At para. 17.

According to Ms Schmidt's lawyer and the ECJ, a transfer in terms of the ARD happened with a change of the supplier. If this opinion is regarded as accurate, then each new placing of an order could lead to the situation that the successful tenderer would have the duty to employ all workers who work for the old supplier. Such an approach would make future businesses more difficult, if the contracted supplier would face these consequences. It is questionable whether such an approach could be useful against the background of recession and the economic need that employers invest in their business.

After the *Christel Schmidt* decision,[412] a change on the bench of judges at the European Court of Justice took place.[413] The court rejected its former opinion. This happened in a case where the plaintiff, *Ayse Süzen,*[414] worked as a cleaner at a German school. Her employer, the Zehnacker GmbH, had a cleaning contract with the school. The school awarded the cleaning contract to another cleaning company. Pending the termination of that cleaning contract, the employment contract with the plaintiff was terminated too. The labour court of the city of Bonn asked the European Court of Justice to answer the question whether, in circumstances where an undertaking terminates a contract with an outside undertaking in order to transfer it to another outside undertaking, and given that there had been no transfer of business assets between the two cleaning companies, article 1(1) of the Directive 77/187/EEC would be applicable.

The European Court of Justice laid the principles of the ARD down and stated as follows,

> "Article 1(1) of Directive 77/187 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses is to be interpreted as meaning that the directive does not apply to a situation in which a person who had entrusted the cleaning of his premises to a first undertaking terminates his contract with the latter and, for the performance of similar work, enters into a new contract with a second undertaking, if there is no concomitant transfer from one undertaking to the other of significant tangible or intangible assets or taking over by the new employer of a major part of the workforce, in terms of their numbers and skills, assigned by his predecessor to the performance of the contract."[415]

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[412] *Schmidt v Spar- und Leihkasse der Früheren Ämter Bordesholm, Kiel und Cronshagen* (ECJ) in *ECR*, 1994, 1311ff.

[413] Junker A, *Europäisches Arbeitsrecht 2003*, 7.

[414] *Süzen v Zehnacker Gebäudereinigung GmbH* in *IRLR* 1997, 255 ff.

[415] Summary to the decision, part 1.

Rejecting its former opinion, the European Court of Justice pointed out that

> "[t]he mere loss of a service contract to a competitor cannot therefore by itself indicate the existence of a transfer within the meaning of the directive. In those circumstances, the service undertaking previously entrusted with the contract does not, on losing a customer, thereby cease fully to exist, and a business or part of a business belonging to it cannot be considered to have been transferred to the new awardee of the contract."[416]

The court differentiated between businesses where the workforce is important, and businesses which might be identified by their operating facilities.[417] The European Court of Justice stated that

> "in certain sectors in which the business is based essentially on the workforce, an economic entity is able to function without any significant tangible or intangible assets and may be constituted by a group of workers engaged in a joint activity on a permanent basis, it is necessary in addition, for there to be a transfer within the meaning of the directive, for that group to continue to exist after the taking over of an essential part of the workforce by the new awardee of the contract."[418]

To answer the question whether the economic entity was transferred under the maintenance of its identity, one has to consider a whole package of factors. The European Court of Justice stated in this respect,

> "In order to determine whether the conditions for the transfer of an entity are met, it is necessary to consider all the facts characterizing the transaction in question, including in particular the type of undertaking or business, whether or not its tangible assets, such as buildings and movable property, are transferred, the value of its intangible assets at the time of the transfer, whether or not the majority of its employees are taken over by the new employer, whether or not its customers are transferred, the degree of similarity between the activities carried on before and after the transfer, and the period, if any, for which those activities were suspended. However, all those circumstances are merely single factors in the overall assessment, which must be made and cannot therefore be considered in isolation."[419]

In the decision of *Carlito Abler v Sodexho MM Catering Gesellschaft*,[420] the *Christel Schmidt* decision found its successor.[421] The facts of the case can be sketched as follows. In November 1990 an orthopaedic hospital contracted out its catering services to a company called Sanrest. It prepared and served meals, using equipment and premises provided by the hospital. Several years later the

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[416] At para. 16.

[417] See Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 923, 934.

[418] Summary of the decision, part 2.

[419] At para. 14.

[420] (ECJ) in Rs. C. 340/01; in *NZA* 2003, 1385 ff..

[421] Junker called it a "Wiedergänger" in Junker A, *Europäisches Arbeitsrecht 2003*,8.

contract was transferred to Sodexho, following a re-tender, on the same basis as Sanrest. Sanrest argued that this constituted a transfer of an undertaking, even though Sodexho had refused to take on any of the employees and did not inherit any of their stocks or materials.

First of all, the European Court of Justice considered catering as an activity that does not rely essentially on manpower, as it requires a lot of equipment. It stated that there was a transfer of a business as a going concern, though one could argue that the hospital only changed its supplier of catering. The European Court of Justice argued in its preliminary ruling that the catering company Sodexho, as a new contractor and transferee of the business, had to take on the liability for the employees, because it carried out the same services and used a substantial part of the assets used by the first contractor and transferor.

This decision shows the importance of the legal nature of the employment relationship. Because of the social entitlements of the European Union, this relationship cannot be described by applying an ordinary contractual model. The concept of the European Court of Justice goes far beyond the concept of an ordinary employment contract. Even if the successor did not intend to acquire the employees and did not acquire anything tangible from the original employer, the provision on the transfer of employees could be applicable. Considering the consequences of the decision in *Carlito Abler,*[422] these risks have to be thoroughly analysed. The possibility of a non-voluntary transfer of employees has to be taken into account.

Certainly it would be great advantage if the South African courts could incorporate the experiences of the ECJ. But it is necessary to mention that clear guidance in dealing with the "going concern" question will hardly be found. Every new case will be a new struggle to evaluate the facts properly and to balance the respective interests.

The LAC held in the decision to *NEHAWU v UCT*[423] that the

> "[l]ack of emphasis thereon or a misunderstanding thereof leads to misinterpretation of the section."[424]

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[422] (ECJ) in *NZA* 2003, 1385 ff..

[423] (LAC) in *ILJ* 2002, 306 ff..

[424] (LAC) in *ILJ* 2002, 306 ff. at para 10.

Despite the small number of decisions, they were not consistent. According to *Boraine* and *van Eck,* there was still a "pressing need" for the clarification of the term "going concern" after the implementation of section 197 of the LRA, especially where the transfer occurred in insolvent circumstances.[425]

It is questionable whether sections 197 and 197A of the LRA will be applicable at the discontinuation of business operations as a result of sequestration or liquidation, if all assets of the insolvent employer will be sold to a single buyer and this buyer takes over some but not all of the old employees.[426]

The Constitutional Court stated in its landmark decision to *NEHAWU v UCT,*[427]

> "The phrase "going concern" is not defined in the LRA. It must therefore be given its ordinary meaning unless the context indicates otherwise. What is transferred must be a business in operation so that the business remains the same but in different hands. Whether that has occurred is a matter of fact, which must be determined objectively in the light of the circumstances of each transaction. In deciding whether a business has been transferred as a going concern, regard must be had to the substance and not the form of the transaction."[428]

The Constitutional Court reached this decision in respect of a solvent business. It is doubtful whether this approach would be changed in insolvent circumstances. Although the circumstances are different, it is rather unusual that there are two different definitions of the same term. Also after the Constitutional Court's consideration, the meaning of the concept of transfer as a going concern under insolvent circumstances remains unclear. It is questionable whether the sale of a business as a going concern takes place when it is transferred after its discontinuance.

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425 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.

426 See example by Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.

427 (CC) in *ILJ* 2003, 95 ff..

428 (CC) in *ILJ* 2003, 95 at paragraph 56.

However, according to *Boraine* and *van Eck*, there was a "golden opportunity" to resolve these uncertainties.[429] Section 197 (2)(a) of the 2000 Draft of the Amendment to the LRA contained a clarification and regulated what kind of "transfer of a business" would be covered by section 197 of the LRA. This subsection did not define the meaning of a "transfer of a business" per se, but the concept of a business "as a going concern". It provided in subsection 2 as follows,

> "(2) A transfer of a business is covered by this section, if –
> (a) an economic entity, consisting of an organised grouping of resources, that has the object of performing an economic activity is transferred; and
> (b) the economic entity retains its identity after the transfer."

For a definition of "going concern", one thus has to consider both subjects of the term. One has thus to examine whether there is an economic entity, and whether this entity is transferred under the maintenance of its identity. It is clear that the going concern concept is based on the wording's ordinary meaning. What is being transferred must thus be "a business in operation so that the business remains the same but in different hands".[430]

Despite possible advantages to defining this crucial term, the 2001 Draft of the Labour Relations Bill no longer contained that definition. The result of that regulation, i.e. the lack of a clear definition, could be seen as a pity.[431] However, the decisions of the European Court of Justice show the problems of definition abundantly clearly, as could be seen *supra*.

The Labour Appeal Court emphasized in *NEHAWU v UCT*[432] the importance of the workforce for the consideration of the "going concern" when it held

> "[a] business is a going concern only if its assets, movable and immovable, tangible and intangible, are utilized in the production of profit (or, in the case of an undertaking, the attainment of its goals). In every business its employees are a vital component and in labour intensive industries the major asset. To say that there can be a sale of a business as a going concern without all or most of the employees going over is to equate a bleached skeleton with a vibrant horse."[433]

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[429] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.

[430] (CC) in *ILJ* 2003, 95 at paragraph 56 (NEHAWU).

[431] Smit N, *Labour Law implications of the transfer of an undertaking*, 427.

[432] (LAC) in *ILJ* 2002, 306 ff..

[433] (LAC) in *ILJ* 2002, 306 ff. at para 10.

Van Niekerk mentions in this respect that there are several indicators which show that a transfer of an economic entity that retains its identity had taken place, e.g.

> "the type of the undertaking, business, trade or services;
> the fact that its operation was actually continued or resumed by the new employer, with the same or similar activity;
> whether or not tangible assets, such as buildings and movable property, are transferred;
> the value of its intangible assets at the time of the transfer and whether they are transferred;
> whether the majority of its employees are taken over by the new employer;
> whether its customers are transferred;
> the degree of similarity between the activities carried on before and after the transfer;
> the period, if any, for which those activities were suspected."[434]

These criteria are in fact the outcome of the jurisprudence of the European Court of Justice. The ARD does not define "going concern" either. It is plausible that the long-established case law of the European Court of Justice will be of significant assistance to South African jurisprudence.

Especially the criterion "whether the majority of its employees are taken over by the new employer" is very problematic. It could lead to the consequence that the transferee would play the main role in this respect.[435] This could have an opposite effect to the legal protection of the concerned employees. The takeover of employees by the transferee is in fact the legal consequence of section 197 of the LRA and cannot be used for the definition of its scope. In this regard, one has to keep in mind that the European jurisdiction is still challenging and tries to reach certainty on this issue. This jurisprudence gave reason for much criticism in the past. Although the South African courts have drawn extensively from the European jurisdiction,[436] it is doubtful if South African courts could profit from European precedents of the last three decades.[437] Because of the lack of legal definition, the South African courts will continue to interpret the meaning of the term "going concern".

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434 An examination of such a basket of indicators by Landman J can be found in *SAMWU & others v Rand Airport Management Co* (LC) in *BLLR* 2002, 1219 ff.

435 Preis U in *Erfurter Kommentar*, BGB § 613a Rn. 39.

436 E.g. in *Foodgro v Keil, Ndima v Waverly Blankets Ltd.* and *Schutte v Powerplus*.

437 Smit N, *Labour Law implications of the transfer of an undertaking*, 427.

Section 197 has been held to be applicable to first phase of contracting out, and by a major opinion to second-generation contracting out and contracting back, i.e. the reversion in-house of a service previously contracted out as well.[438] It was questionable whether the second-generation contracting out (also termed a second-generation transfer)[439] could be subsumed under section 197 of the LRA. In the decision *COSAWU v Zikhethele Trade (Pty) Ltd & another*[440] the Labour Court held in respect to the clear wording as follows:

> "Although the matter was not pertinently argued before me, a compelling argument can be made, based on the express language in Section 197 of the LRA, that the requirement in s 197(1)(b) that a transfer of business be by one employer to another precludes its application to second generation contracting-out, because in such arrangements nothing is transferred by the old employer to the new employer. Hence, second generation contracting out is effectively exempted from the application of s 197."[441]

The court referred to the term "by" and concluded correctly that nothing was transferred *by* the old employer. The theoretic possibility to read the text of section 197 (1)(a) LRA (2002) "the whole or any part of the business is transferred by *or from* the old employer as a going concern" is to reject.[442] It is certainly the courts' task to interpret to Acts, but this interpretation finds its end at the clear text of a section as stated *supra*. But it is of course possible to read section 197 LRA (2002) in conformity with the Constitution. The Labour Court referred to the European regulation and jurisdiction. It stated that in situations of the transfer of a business, there is a necessity to consider the situation from the employment perspective and not from a perspective conditioned by principles of property, insolvency or company law.

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438 Van Niekerk A, *Presentation Outline: Outsourcing and transfer of undertakings* (Labour Law Conference 2003). Under the following circumstances the courts applied section 197 LRA:
-a changeover of lessees running a restaurant
-the outsourcing of management of a canteen facility
-a changeover of cleaning contractors providing cleaning services to a hospital
-the outsourcing of the function of cleaning of the premises of a branch of a bank
-the reversion to the customer from an external contractor of the functions of fire fighting and baggage handling at an airport
-the outsourcing of management of a sports and leisure centre
-the switch by a motor manufacturer of car dealerships within the same municipality.

439 Second generation contracting-out refers to the situation where a contractor performing an outsourced activity loses the contract which is then taken over by another contractor. –Bosch C, *Business restructuring: some important labour law issues*.

440 (LC) in *ILJ* 2005, 1056ff..

441 (LC) in *ILJ* 2005, 1056, 1056.

442 See Todd C *et al, Business Transfers and Employment Rights in South Africa*, 28 at footnote 54.

In respect to the intention of the legislator to protect employees from losing their jobs it stated further that,

> "... a less literal and more purposive approach is justified in the context of Section 197. As stated earlier, the section is intended to protect employees whose security of employment and rights are in jeopardy as a result of business transfers".[443]

3.3.2) The outcome for the employment contract

Considering the provisions of sections 197 and 197A of the LRA, it is obvious that there are similarities as well as differences in text and legal consequences in the different situations of the transfers of undertakings in solvent and insolvent circumstances. A similarity of both regulations is the automatic transfer of the contracts of service. That means that the transferee will automatically substitute the transferor in his legal position with respect to the employment contract. The principle of non-interruption and continuity of employment is applicable for solvent as well as for insolvent businesses.[444]

Section 197A (2) LRA provides in this regard as follows,

> "(2) Despite the Insolvency Act, 1936 (Act No. 24 of 1936), if a transfer of a business takes place in the circumstances contemplated in subsection (1), unless otherwise agreed in terms of section 197 (6)—
> (*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;
> …
> (*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."

With respect to insolvent businesses, all rights and obligations between the transferor and the employee the terms of section 197A of the LRA provided for an important exception. Section 197A of the LRA provides in this respect,

> "(2) Despite the Insolvency Act, 1936 (Act No. 24 of 1936), if a transfer of a business takes place in the circumstances contemplated in subsection (1), unless otherwise agreed in terms of section 197 (6)—
> …

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[443] (LC) in *ILJ* 2005, 1056, 1068.

[444] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1857.

> (*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;… "

One can with good reasons criticise the fact that section 197A of the LRA provides for the automatic transfer of employment contracts in cases of a transfer of an insolvent business without any accompanying rights and obligations. These exceptions to the transfer are the same as already fixed in section 197 (2) of the LRA (1995). The problems regarding the scope and meaning of "rights and obligations" remained unsolved, like several other problems of the old regulations.

Prior to the 2002 amendments, the question was discussed whether the labour law principles flowing from section 197 of the LRA were applicable in insolvency matters or not. According to *Landman J* as decided in *SA Agricultural Plantation & allied workers Union v HL Hall & Sons Group Services Ltd & others*[445], section 197 of the LRA was not applicable in circumstances of insolvency. In his remarkable statement he argued, "the reach of the Labour Relations Act of 1995 halts once insolvency enters the picture".[446] The conclusion to this precedent was that the insolvency law would prevail over the regulations of the LRA. The view that the labour law was not applicable when insolvency entered the picture was disadvantageous for employees, since South Africa's insolvency law granted only minimal protection for the claims of employees and there was not yet a guaranteed wage fund.[447]

The Labour Court disagreed in the cases of *Ndima v Waverley Blankets Ltd* [448] and *Waverley Blankets Ltd v CCMA & others*[449] with the statement that the labour law regulations would not be applicable in insolvency circumstances. According to *Zondo J*

> "[There was] no indication in Landman J's judgement that the jurisdiction of the Labour Court was in issue nor is there any indication that the applicability or inapplicability of the Labour Relations Act, 1995 was an issue in the matter. The issue before *Landman J* would appear to have been whether there was going to be a dismissal of the applicant's union members and, whether, if such dismissal occurred, same would be unfair and whether the requirements for a final interdict had been satisfied."[450]

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445 (LC) in *ILJ* 1999, 399 ff..

446 (LC) in *ILJ* 1999, 399 ff. at para. 21 and 22.

447 Smit N, *Labour Law implications of the transfer of an undertaking*, 58.

448 (LC) in *ILJ* 1999, 1563 ff..

449 (LC) in *ILJ* 2000, 2738 ff..

450 (LC) in *ILJ* 1999, 1563 ff. at para. 25.

Even after the last statutory amendments, the main problem remained the same, i.e. the conflicting aims of the insolvency and labour laws. Whereas one of the aims of labour law is to provide for job security and continuity of employment, the insolvency law has the ultimate aim to realise and distribute the assets belonging to the insolvent estate.[451] The LRA is based on the intention to avoid dismissals altogether or to reduce the number of retrenchments. It is necessary to reach this aim also in insolvency matters, especially against the creditor's interests and the intention of the insolvency law to finalise the business[452]. It is a fundamental political decision whether the regulations of the LRA should prevail over the Insolvency Act provisions. Nevertheless, the legislation gave the courts a broad discretion in this regard.

The formulation "[d]espite the Insolvency Act" in the first sentence of section 197 (2) of the LRA (2002) refer to the termination of an employment contract in terms of section 38 of the Insolvency Act. The main problem of the conflicting regulations of section 38 of the Insolvency Act[453] and section 197 of the LRA (1995) remained unresolved by the amendments of 2002. The conflict of the different interests and applicable laws still exists, and it is a question of interpretation, which effect the insolvency and the transfer will have in respect to the employment contracts as examined *supra*[454].The amendments of 2002 do not abolish the crucial interplay between transfer and termination, but only shifted the termination for a period of 45 days after the appointment of the final trustee. The Insolvency Amendment Bill of 2000 attempted to address these shortcoming. It gave procedural rights to employees of insolvent employers or their representatives as the employer had to notify them of the institution of legal proceedings for sequestration.[455] This was the basis for a regulation of the substantive consequences of insolvency in an equitable manner.[456] Nevertheless, even these rights did not resolve the dilemma between insolvency and labour law.

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451 Boraine A & Van Eck S, The New Insolvency and labour legislative package: How successful was the integration? (2003) *ILJ* 1840, 1851.

452 Boraine A & Van Eck S, The New Insolvency and labour legislative package: How successful was the integration? (2003) *ILJ* 1840, 1851.

453 In its version prior to the amendments of 2003.

454 At 2.3.10; for a detailed examination see Todd C *et al, Business Transfers and Employment Rights in South Africa*, 136 ff..

455 The right of disclosure of information and consultation will be considered *infra.*

456 Smit N, *Labour Law implications of the transfer of an undertaking*, 407.

An exception to the automatic transfer of the employment contract is given if there is a scheme of arrangement or compromise that deals with this situation in another way. It is questionable if such an exception is acceptable, bearing in mind the aim of the amendments. According to the Minister, the amendments should try to deal with the situation of high unemployment and the high number of retrenchments. It is thus necessary to give the affected persons the highest possible legal certainty. Making the automatic transfer of employment contracts subject to contrary agreement could weaken the employee's position and lead to more uncertainty. In this matter, one has to remember the legal nature of the relation between employer and employee as well as the task of the labour law to protect the weaker position of the employee. It is questionable whether the employers' parties could agree among themselves for the exclusion of the employee's transfer. This problem was considered in several important decisions of the South African Courts. In *Schutte & others v Powerplus Performance (Pty) Ltd & another,*[457] the Labour Court decided that the prevention of the results from a transfer as a going concern as stipulated in section 197 of the LRA could not be an item of an agreement between transferor and transferee. The Labour Appeal Court affirmed this jurisdiction in its *Foodgro, a division of Leisurenet Ltd v Keil*[458] decision.

In *NEHAWU v UCT & others,*[459] the majority of the Labour Appeal Court came to a contrary result. According to that decision, it is possible to prevent the transfer of employees from the transferor to the transferee by an agreement. According to the LAC, the application of section 197 of the LRA is conditional. Transferor and transferee should be offered the opportunity to avoid the impact of section 197 of the LRA. They shall be entitled but not obliged to make a provision for the transfer of workers as part of the transaction. The parties could consider the fact, if they wished to transfer the business without the workforce.

The majority of judges of this LAC decision held,

> "Purchasers and sellers of businesses as going concerns are at liberty to define what is included in that concept, and generally do. (cf Smithfield Cold Storage Co v Kamp 1920 AD 183; General Motors SA v Besta Auto and Another supra which concerned movables and work in progress.) When used in section 197(1) the phrase "going concern" must necessarily include the employees and where the seller and purchaser negotiate and agree on a sale as a going concern of a business or part thereof, the necessary implication is that they agree that the employees or a material part thereof are part and parcel of the transaction."[460]

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457 (LC) in *BLLR* 1999, 169 ff..

458 (LAC) in *ILJ* 1999, 2521 ff..

459 (LAC) in *ILJ* 2002, 306 ff..

460 (LAC) in *ILJ* 2002, 306 ff.. at para 11.

The minority of judges rejected this view and argued in favour of an automatic transfer of the employment contracts. This opinion was incidentally aligned with the above-mentioned decisions of *Schutte & others v Powerplus Performance (Pty) Ltd & another*[461] and *Foodgro, a division of Leisurenet Ltd v Keil*[462].

Above all, the Constitutional Court agreed in its *NEHAWU v UCT*[463] decision under the judgment of *Ngcobo J,* with the minority of this LAC decision. The Constitutional Court stated,

> "The majority decision therefore has the potential to deny to the workers protection against job losses and leaves their protection solely in the hands of the employers. …
> [R]egard must be had to the declared purpose of the LRA to promote economic development, social justice and labour peace. The purpose of protecting workers against loss of employment must be met in substance as well as in form."[464]

In its arguments the Constitutional Court laid down the constitutional principles behind the regulation of section 197 LRA,

> "The purpose of the legislature involves protecting the interests of both the employers and workers. Employers are at risk as far as severance pay is concerned. Workers are at risk in relation to their jobs. Properly construed section 197 is for the benefit of both employers and workers. It facilitates the transfer of businesses while at the same time protecting the workers against unfair job losses. That is a balance consistent with fair labour practices."[465]

Finally, *Ngcobo J* decided,

> "I conclude that upon the transfer of a business as a going concern as contemplated in section 197 (1)(a), workers are transferred to the new owner. The fact that there was no agreement to transfer the workforce or part of it between UCT and the contractors did not, as a matter of law, prevent a finding that the outsourcing was a transfer of a business as a going concern."[466]

An agreement between transferor and transferee is, according to this decision, not necessary to constitute a transfer of employment contracts. It is also not possible to deny the transfer of employment contracts by such an agreement.

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461 (LC) in *BLLR* 1999, 169 ff..

462 (LAC) in *ILJ* 1999, 2521 ff..

463 (CC) in *ILJ* 2003, 95 ff..

464 (CC) in *ILJ* 2003, 95 ff. at para. 61.

465 (CC) in *ILJ* 2003, 95 ff. at para. 70.

466 (CC) in *ILJ* 2003, 95 ff. at para. 71.

Section 197A of the LRA is not limited to an insolvent employer. According to section 197A (1)(b) of the LRA, it is also applicable if there is a scheme of arrangement or compromise which is being entered into to avoid winding up or sequestration for reasons of insolvency. In numerous cases the result of these arrangements is a transfer of shares.[467] The problems with these transfers of shares were already mentioned above and *Zondo J* spoke about a "crying need" for an amendment to labour legislation and section 38 of the Insolvency Act.[468]

Because of the clear wording of sections 197, 197A of the LRA in these matters, the courts are not entitled to disregard this wording. One has to bear in mind that the legislature knew of the criticism on section 197 of the LRA (1995) butdoes not resolve the problems. Because of the loophole to protect all economic stakeholders, the need for further legislative steps becomes clear.

3.3.3) The right to object

As *Smit* said, a power to object has been recognised on the international front, if not in South Africa. As an example for the recognition abroad, a short look to the Garman law could be useful. The German legislature had to enact the Directive 2001/23/EC into national law. This happened by the implementation of § 613a (5) and (6) BGB at 1 April 2002. Under the current law, employees are entitled to object to the transfer of their employment relationships from the transferor to the transferee within one month after they have been informed as described by statutory provision, i.e. § 613a (6) BGB. If an employee exercises his right to object, his employment contract will remain with the old employer. In numerous cases, this power to object will lead to the situation that the transferor will no longer be able to employ the employee. The dismissal of the objecting employee on the grounds of operational reasons will be the ordinary consequence. In cases where the transferor retained parts of the business, he is not allowed to dismiss the objecting employees for operational reasons. If the objecting employee falls within the scope of the German Protection against Unfair Dismissals Act, he could only be dismissed after a so-called social selection.

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[467] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1863.

[468] (LC) in *ILJ* 1999, 1563, 1579 G. For further quotes of that decision see at 2.3.8 *supra*.

In South Africa, even after the amendments of 2002 the LRA (2002) does not explicitly offer a right to object to the transfer of employment contracts. The amended section 197A of the LRA (2002) contains two exceptions to its predecessor's scope. These exclusions could probably offer a *de facto* power to object to the concerned employee. The concerned parties can narrow or widen the scope of the applicability of section 197A of the LRA by acting in special ways. According to 197A (1)(b) of the LRA, a transfer of business can be subsumed under section 197A of the LRA if

> "a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency".

Such a scheme can thus lead to the consequence of the transfer of the employment contracts by operation of law. An agreement in the sense of section 197A (2) of the LRA excludes the ordinary consequence of section 197A of the LRA.

> "(2) Despite the Insolvency Act, 1936 if a transfer of a business takes place in the circumstances contemplated in subsection 1, *unless otherwise agreed*[469] in terms of section 197 (6) -
> 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 (paragraph a)."

An agreement in the sense of sections 197A (2), 197 (6) of the LRA excludes the employment contracts from the automatic substitution of the old employer by the transferee. Such an agreement has to take place in accordance with section 311 of the Companies Act, which provides for a mechanism whereby the company is enabled to conclude agreements with the shareholders as well as with the creditors of this company. Section 311 (1) of the Companies Act stipulated,

> "[w]here any compromise or arrangement is proposed between a company and its creditors or any class of them, the Court may, on the application of the company or any creditor or any member of the company or, in the case of a company that is being wound up, of the liquidator . . . order a meeting of creditors or class of creditors or of members of the company or class of members (as the case may be) to be summoned in such manner as the Court may direct".

This is only prima facie preponderance of the business's interests above the employees' interest, but if the business could not be saved, all jobs would come to an end. Because of the criticism of the lack of the employees' power to object after the enactment of the LRA, it was plausible that the legislature would provide for this matter in a positive or negative way. If one looks at the

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[469] Italics added.

statutory and jurisdictional basis abroad,[470] one could acknowledge several possibilities on how to deal with these matters, i.e. the right to object and the consequences of the exercise of that power. The need to consider these problems was clear. However, the amendment package did not deal with this problem through a positive or negative regulation of this subject.

It is rather disappointing that the South African labour courts have considered the power to object and held, that because of the inopportune wording of section 197 of the LRA, that such a right did not exist. The courts found this to be the legal position without referring to the constitutionality of the statutory provision interpreted in this way.[471]

3.3.4) Transfer-related dismissals

Prior to 2002 the LRA stipulated three broad reasons that could be regarded as fair for dismissals in terms of section 188 of the LRA. These reasons were related to the conduct and capacity of the employee as well as the operational requirements. According to *Smit*, it was necessary to add a fourth category to the above-mentioned ones, because there was no category in respect of transfer-related unfair dismissals.[472] If one acknowledges that there is a lack of employee protection in this regard, such a category had to be submitted. *Smit* examined this subject extensively and, of course, also with reference to the European law, where a category of transfer-related dismissals is accepted.[473] It is questionable whether dismissals that are related to operational requirements could contain transfer-related dismissals.

In terms of section 213 of the LRA, the term operational requirement means "Requirements based on the economic, technological, structural or similar needs of an employer". This seemingly all-encompassing definition could be wide enough to contain the circumstances where transferor or transferee dismisses employees because of the size or quality of the workforce too.[474]

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[470] With effect from 1 April 2002, § 613a (6) BGB explicitly provide for the employee's right to object to the transfer of his contract.

[471] Smit N, *Labour Law implications of the transfer of an undertaking*, 333ff..

[472] Smit N, *Labour Law implications of the transfer of an undertaking*, 333; Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1858.

[473] In Germany § 613a (IV)(1) BGB states that a retrenchment by the old or new employer occurred because of the transfer of the establishment is void. This provision is based on the Directive 77/187/EEC and was implemented at the 21 August 1980.

[474] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1858.

Initial drafts of the 2002 amendments considered a dismissal as automatically unfair if this dismissal happened on account of a transfer in the sense of section 197 of the LRA. These drafts provided for a few exceptions. They granted the transferor permission to dismiss parts of his work force based on his own operational requirements or those of the transferee. Even the transferee should have the right to dismiss the employees concerned because of his operational requirements. Both possibilities to retrench employees had to take place in accordance with the stipulations of chapter 8 of the LRA, which deals with dismissal matters.[475] However, during the legislation process the intention to provide a fourth category without exceptions became clear. The Amendment Acts of 2002 no longer contain these exceptions and rights of the transferor or transferee. The change from the previous draft to the final Act proves the legislature's intention to make any dismissal in the transfer of the business's matters automatically unfair. Under the current law there is thus a distinction between dismissals based on operational requirements during the transfer situation and dismissals (solely) based on the transfer as a going concern. This distinction faces some problems and disadvantages, especially for practitioners.

Section 187 of the LRA (2002) provides in its subsection (1)(g) as follows:

> "A dismissal is automatically unfair … if the reason for dismissal is-…
> (g) a transfer, or a reason related to a transfer, contemplated section 197 or section 197A;… "

A transferor may not retrench its employees, even if the purchaser does not wish to engage them. The other categories of automatic unfair dismissals within section 187 of the LRA (2002) relate to participation in protected strikes, dismissals of pregnant employees and unfair discrimination. These dismissals can certainly be seen as the most unacceptable kinds of dismissals.[476] It is rather doubtful that the employer's decision to make the undertaking more profitable shall fall under the group of such unacceptable dismissal.

With respect to a dismissal related to a transfer in terms of sections 197, 197A of the LRA (2002), the employer will not have any defence for his decision to retrench as a result of the transfer.[477] To increase the profitability of the business is the foremost intention of every employer; only a

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475 Bosch C, Balancing the Act: Fairness and Transfer of Business (2004) *ILJ* 923, 937.

476 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1859.

477 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1859.

solvent undertaking is able to increase its workforce. The profitability is thus essential for the security of the employment too. Only in cases where the employer works successfully, is he able to work for the good of society as a whole.[478] This is also an outflow of his freedom of trade, occupation and profession, as provided in section 22 of the Bill of Rights.

The legislature tried to balance the different interests inherent in every dismissal by drawing different categories of reasons for retrenchment. But in transfer matters these distinctions would not work sufficiently. Almost all retrenchments during the process of a transfer of a business will be linked to the transfer. If all these dismissals would be automatically unfair, the law would put the employer in a position where he would not be able to act on, and even react to, business needs.[479] Such a restriction of the employers' rights could interfere with the relationship between employer and employee in an inappropriate way. One cannot seriously consider this result to be the legislature's intention.

The second question is whether a special category for transfer-related dismissals would lead to more certainty. The important distinction between transfer-related dismissals and dismissals based on operational requirements leads to different consequences. But in many cases neither the employer nor the employee is aware of this difference.[480] In cases where the dismissal is only related to operational requirements, sections 189 and 189A of the LRA would be applicable. In transfer-related retrenchments the stricter section 187 (1)(g) of the LRA will be applicable. The employer will have problems to prove the facts that led to a dismissal purely based on operational grounds. Against the background of such problems, prospective purchasers of the business could be discouraged from buying the business as a going concern. If the transferee dismisses some of the transferred employees for operational reasons, it could happen that the court consider these dismissals as transfer related. The fact that transferor and transferee have genuine business needs and therefore operational requirements makes the situation difficult enough without a confusing fourth category. In cases of operational requirements the economic, technological and organisational reasons for the dismissal must relate to the viability of the business.[481]

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[478] Smit N, Should Transfer of Undertakings be statutory regulated in South Africa? (2003) *Stellenbosch LR* 205, 227.

[479] Bosch C, Operational Requirements Dismissals and section 1997 of the Labour relations Act: Problems and Possibilities (2002) *ILJ* 941, 946.

[480] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1846.

[481] Bosch C, Operational Requirements Dismissals and section 1997 of the Labour relations Act: Problems

Because of this need the employer cannot argue that retrenchments would facilitate the sale. The retrenchment may not be used as a utility for a better negotiating position of the transferee and his wish to get a better price.[482]According to *Le Roux,* it is possible for the transferee to take the bona fide decision to retrench employees in order to cut his costs after a transfer, because this decision would not fall under the scope of section 187 (1)(g) of the LRA[483]. This enables a new owner to restructure the insolvent business. If the employer retrenches some members of the former labour force, he will have the chance to secure the employment contracts of other employees. Disadvantages for the minority could be to the advantage of the majority of the work force as well as of the other stakeholders, who profit from the successful undertaking. The interpretation and application of the relevant provisions could be more problematic after the amendments than before. Finally, it is questionable how long the transferred employees will be protected against retrenchment by the purchaser and this could depend on the facts of every single case.[484] Beside the fourth category for a fair dismissal mentioned above, the legislature introduced in 2002 a new category of constructive dismissals.[485] Section 186 (1)(f) LRA stipulates as follows,

> "Dismissal" means that ...
> (f) an employee terminated a contract of employment with or without notice because the new employer, after a transfer in terms of section 197 or section 197A, provided the employee with conditions or circumstances at work that are substantially less favourable to the employee than those provided by the old employer."

The employee thus has to show that either the circumstances or the conditions are less favourable after the transfer. This stipulation is full of uncertainties. The terms "conditions" as well as "circumstances" have to be defined and applied. It is debatable, if "conditions" refers to "terms and conditions of employment" as mentioned in section 197 of the LRA. If so, the possibility to claim for an automatic transfer of terms and conditions of employment as stipulated in section 197 of the LRA would be "somewhat anomalous".[486]

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and Possibilities (2002) *ILJ* 941, 950.

[482] Bosch C, Operational Requirements Dismissals and section 1997 of the Labour relations Act: Problems and Possibilities (2002) *ILJ* 941, 951.

[483] Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) CLL 61, 68.

[484] Grogan J, *Workplace Law* (2003), 143.

[485] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1859; Smit N, *Labour Law implications of the transfer of an undertaking*, 422.

[486] Van Niekerk A, *Unfair Dismissal*, 21.

The term "circumstances" is vague too. What circumstances at work would have to be less favourable after the transfer? According to *Le Roux,* this term refers to physical circumstances at work.[487] The vague term "circumstances" could include countless situations. According to *Le Roux*, a strict interpretation of this regulation could have ludicrous consequences.[488]

A third problem flows from the phrase "substantially less favourable". In this respect one could take the same scope as for the term "intolerability" in section 186 (1)(e) of the LRA.[489] However, this opinion is not very convincing. The legislature had the opportunity to use this term in section 186 (1) (e) *and* (f) of the LRA, but it did not. From the wording of this regulation one can conclude that the employee will have much freedom in these circumstances. In every single case certain objective circumstances should be proven. The problem with the phrase "substantially less favourable" also becomes evident if one compares the stipulations of sections 186 and 197 of the LRA. Section 197 (3)(a) of the LRA speaks about terms and conditions that are "on the whole not less favourable" and section 186 (1)(f) of the LRA about conditions and circumstances that are "substantially less favourable". The meanings of both regulations are different. On the other hand, the comparison between section 186 and 197 of the LRA seems to show an advantageous position for the transferee. The employee concerned has to work for the transferee under less favourable conditions until these conditions reach the grade of "substantially less favourable". According to *Smit*, this provision is not suitable. It is not clear why the legislature provided for a substantial downgrading of working conditions before the employee can complain about this situation.[490]

One has to presume that also in dismissal matters the legislature did not reach its above-mentioned aim to bring more certainty to the transfer law. The category of transfer-related dismissals brought more uncertainty to the contracting partners of the transfer of the undertaking itself as well as to the employees and practitioners. A fourth category of dismissals is neither necessary nor useful with respect to maintaining a balance between the conflicting interests surrounding a transfer of an undertaking, because all dismissal problems could be solved by applying the other three categories, which make a judgemental and balancing decision in every single case possible.

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[487] Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) *CLL* 61, 67.

[488] Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) *CLL* 61, 67.

[489] Van Niekerk A, *Unfair Dismissal,* 21.

[490] Smit N, *Labour Law implications of the transfer of an undertaking*, 423.

3.3.5) Disclosure of Information and Consultation

As already mentioned above, the final trustee is not allowed to terminate the employment contracts unless the employees have had the opportunity to respond in consultations with him. The disclosure of sufficient information is the logical basis for a consultation. In circumstances where the insolvent undertaking shall be transferred, the stipulations of sections 197, 197A and 197B of the LRA have to be considered. Section 197B of the LRA, which deals with the disclosure of *information* concerning insolvency, provides in subsection (1), that

> "[a]n employer that is facing financial difficulties that may reasonably result in the winding-up or sequestration of the employer, must advise a consulting party contemplated in section 189 (1) [LRA]."

The aim of the consultation is the saving or rescuing of the complete insolvent business or at least a part thereof. This aim requires providing information to the employees' parties with respect to financial and business inputs from the employer or his representative. There is of course the practical interest of the individual employees to know the actual situation of their establishment. When insolvency threatens the business, it would be advantageous for them if they would have enough time to find a new job. Nevertheless, it is questionable, whether the provision of information would lead to an opposite effect and endanger job security. It is obvious that in some case the employer will not have an interest in informing anyone of such sensitive information.

As mentioned above, neither employees nor their representatives were per se enabled to be informed or to participate in a consultation with the employer or the trustee or liquidator of the insolvent business under the law prior to 2002, if they were not creditors of the business. This was the ordinary case when the employer owed them wages. However, it was their position as creditors and not their position as employees of the undertaking that led to the provision of the right to be informed. The Insolvency Amendment Act 2002 provides for the extension of the right to be informed of the forthcoming sequestration or liquidation. It fixes an obligation for the employer to notify and consult with the employees who are facing dismissals because of the sequestration or liquidation. Regarding the information for the workers concerned or their representatives, the new section 38 of the Insolvency Act implies some important rights. According to subsection 6, the final trustee or liquidator is not entitled to terminate the employment contracts, unless he consulted with the employees' representatives and gave them time to respond. Although section 38 of the Insolvency Act does not contain the terms "inform" or "information", it is obvious that

this information is the logical basis for consultations. Consultations as fixed in subsection 6 and 7 of section 38 of the Insolvency Act would not make any sense without sufficient information for the parties concerned. Subsection 6 thus contains not only a list with the representatives and employees who have to be consulted, but implied also a list of the persons concerned who have to be informed by the trustee. Section 38 (6) of the Insolvency Act stipulates that

> "[a] trustee may not terminate a contract of service unless the trustee has consulted with—
> *(a)* any person who the insolvent employer was required to consult with, immediately before the sequestration, in terms of a collective agreement defined in section 213 of the Labour Relations Act, 1995 (Act No. 66 of 1995);
> *(b)* a workplace forum …
> *(c)* a registered trade union representing employees whose contracts of service were suspended in terms of subsection (1) and who are likely to be affected by the termination of the contract of service, if there is no such workplace forum; or
> *(d)* the employees whose contracts of service were suspended in terms of subsection (1) and who are likely to be affected by the termination of the contract of service or their representatives nominated for that purpose, if there is no such trade union."

The last word of paragraph (c) makes clear that disclosure of information to every single employee is not necessary if there are employee's representatives. If one has the opinion that the employees concerned are stakeholders of the insolvent business, it is obvious that their exclusion from the consultations would not be useful to reach a consensus between *all* stakeholders. However, such a position would involve the position and task of employee's representatives.

It is a fundamental question which information the trustee or liquidator is required to give and what aims the consultations shall have. Section 38 (7) of the Insolvency Act provides in this respect as follows,

> "The consultation referred to in subsection (6) 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
> (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."

The legislative aim is thus that the consulting parties reach consensus on appropriate measures to save or rescue the whole or part of the business. This requires financial and business information from the employer. However, the extent of the consultations remains unclear. The courts had not considered the consultations in terms of section 38 of the Insolvency Act. One could probably use the meaning of consultation as it is used in matters of retrenchments.[491] But it is not excluded to acknowledge a lower level of scrutiny compared with consultation in the sense of section 189 of the LRA.[492]

A problem is the position of independent contractors and their employees, who would suffer from a sequestration of the employer to whom they provide services. These persons can be considered as stakeholders in the insolvent business, but no protection is made regarding them. Only immediate employees are under the scope of the application of the new section 38 of the Insolvency Act.

If the employees wants to make a proposal to save the business, they must, according to section 38 (8) of the Insolvency Act, submit this proposal within 21 days of the appointment of the final trustee, liquidator or co-liquidator, unless the trustee has agreed otherwise with the employee's party.

In general, is doubtful that the employees or their representatives will in all cases be able to make useful contributions. One reason for this is the better knowledge of business matters of the employer in general. It is also doubtful whether the potential buyer of the insolvent undertaking should be present during the consultation and negotiation.[493]

A further problem regarding the consultation with employees can arise if the provisional trustee, who commences with consultations with the employees' party, is not the same person as the final trustee. Nothing in the Insolvency Act prevents the provisional trustee to commence with the other party, but he is not allowed to terminate the employees' contracts. But the vision of the provisional trustee or liquidator might not necessarily be the same as the plans of the final trustee.

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491 Boraine A & Van Eck S, The new insolvency and labour legislative package: How successful was the integration? (2003) *ILJ* 1840, 1848.

492 Boraine A & van Eck S, The new insolvency and labour legislative package: How successful was the integration? (2003) *ILJ* 1840, 1848 Footnote 45.

493 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1849.

Boraine and *van Eck* argued that a transfer of the insolvent business would be more attractive for the purchaser if the employees could make suggestions.[494] As mentioned above, one could reply that the right to make suggestions could make the purchasing of the undertaking less attractive per se. Competitors with knowledge about the financial situation of the undertaking could act in a more aggressive manner to eliminate a competitor. It is also doubtful whether a labour force that participated in transfer negotiations would not be regarded as too "active" for a potential purchaser.

The South African provisions regarding disclosure of information and consultation are doubtless intended to prevent employees from losing their livelihoods without the chance to act in favour of a rescue of the insolvent business. Despite the above-mentioned problems, the legislator tried to highlight the employees' rights. According to *Boraine* and *van Eck*, this was a step in the right direction.[495] Nevertheless, it remains unclear whether the attempt to strengthen the rights of the employees is advantageous for the affected persons. It is questionable that the obligation to consult the employees or their representatives will threaten the employers' freedom of business and contract in an inappropriate way.

The German legislature had to enact the Directive 2001/23/EC[496] into national law. The German law went distinctly further than the directive with regard to the disclosure of information to the individual employee. The European law only required information for the single employee in undertakings without the possibility of electing a workers' council. § 613a (5) BGB provided for the disclosure of information to all affected employees irrespective of the undertaking's size and the existence of a workers' council. The employees have to be informed in writing or at least a form similar to written form (as stipulated in § 126a BGB), regarding:

- the date or proposed date of the transfer;
- the reason for the transfer;
- the legal, economic and social implications of the transfer for the employees; *and*
- the intended measures to be taken with respect to the employees.[497]

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494 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1849.

495 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1849.

496 Regarding the disclosure of information, Art. 7 (VI) of the Directive was implemented.

497 Italics added.

According to the leading opinion,[498] a reason for the transfer does not refer to the legal character , but to the economic background. It is thus not necessary to inform the affected employees about the legal technicalities involved in the transfer. The employer has to inform employees about all measures in connection with the employees' professional development,[499] or measures of the agreement related to social plans or equalisation of interests. The duty to inform the employees affects the transferor and the transferee as joint debtors. The employer has fundamentally an interest to remain silent about sensitive information on the intended commercial measures. It is questionable why the German legislature enlarged the group of informed persons in such a way. If only the representatives of the works council would be informed and consulted, their business discretion will protect the employer's interests. The duty to inform the individual employee is problematic if one keeps in mind that the employee does not have to follow such business discretion as the members of the works council often do.

The principle of co-determination and participation of employees is undisputed in Germany and acknowledged by employers. However, regarding the right of disclosure of information, one can show with a single example that the regulation of § 613a (5) BGB is not in the interests of the employers. According to § 613a (6) BGB the employees have a right to object to the transfer of their employment contracts within one month after they have been informed as described in § 613a (5) BGB. This one-month period starts after the employees have been completely informed. Otherwise the employees have a non-limited right to object to the transfer of their employment relationships, which is bound by forfeiture. The lack of limitation is obviously very disadvantageous for the employers concerned, because they would be obliged to employ the employee further, if it is possible to do so.

[498] See Müller-Glöge R at *Münchener Kommentar*, BGB, § 613a at no. 107 and footnote 347.

[499] BT-Drucksache 14/7760 section 19 – printed matter of the German Parliament.

3.4) Final Conclusion

According to *Boraine* and *van Eck,* in some respect section 38 of the Insolvency Act (2003) is not well aligned with the rest of the Insolvency Act.[500] In addition to the new set of problems, it should be mentioned that South African insolvency law is still behind the international trends of rescue culture.[501] The intention to reach consensus on measures for the rescue of the business is a step in the right direction. The new rescue philosophy brings South African insolvency law closer to international standards. There is no doubt that the intention of the amendment package of 2002 was to prevent employees from being in a situation where their contracts would be terminated in "going concern" circumstances. It has to be said that on the one side section 82 of the Insolvency Act provides for the running of a business as a going concern in order to liquidate this business finally; on the other side, there is the legislative intention to rescue the business and protect employees from losing their jobs in accordance to section 38 of the Insolvency Act

Comparing the South African provisions for communicating information to employees or their representatives to the German regulation of § 613a (6) BGB, the South African situation seems to be closer to the regulation of the ARD than to the German one. Whereas Article 7 of the Directive 2001/23/EC requires individual employees to be informed only where there are no employee representatives, the German implementation also requires every single employee to be informed in undertakings which have a representative body, i.e. the works council. This leads to several disadvantages and uncertainties for the employer, as has been shown *supra*. In contrary, the South African legislator achieved the aim to protect the employees' interest in disclosure of information. On the other side, the employer is allowed to inform just a representative of the employees, if such representation does exist.

With the current and anticipated changes in the global economy, corporations must have more flexibility to make important decisions regarding the efficiency of operations and the financial bottom line without strong interference of government regulations. This is especially important in the light of the globalisation of manufacturing and agricultural production. In fact, the EC has to react to these changes in the global economy. Under the term "globalisation" employers and

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[500] Boraine A & Van Eck S, The New Insolvency and labour legislative package: How successful was the Integration? (2003) *ILJ* 1840, 1860.

[501] Boraine A & Van Eck S, The New Insolvency and labour legislative package: How successful was the Integration? (2003) *ILJ* 1840, 1860.

several politicians require more flexibility from the enterprises to make important decisions regarding the efficiency of their operations easier. This flexibility of companies is only possible in the absence of strong interference of government regulations.[502] One can see the need to resolve the problems regarding the application of the out-sourcing or transfer of employment contracts, the ability of the new employer to negotiate changes in the existing contracts of the transferred workers and the effect of a dismissal that is connected to the transfer to correspond the Directive with the requests of the modern economy. While the ARD may provide short-term guarantees to current workers, it is a shaky foundation for employment and economic growth in the end.[503]

Boraine and *van Eck* described the amendment package of 2002 as the most significant manifestation of pressure exerted by the labour movement on the insolvency law fraternity in South African legal history.[504] Not only was the Insolvency Act amended, but so also were labour law-related acts. This makes it clear that the legislature had the aim to integrate insolvency and labour law principles and procedures. This integration and the solutions of the problems that arose after the enactment of the LRA (1995) were of great importance. The legislature was successful in resolving some of the main problems experienced with the old section 38 of the Insolvency Act, if one views the new section 38 of the Insolvency Act as a whole.[505]

The main conflict which had to be resolved by the legislature was the fact that the previous section 38 of the Insolvency Act provided for the termination of the employment contract, whereas section 197 of the LRA provided for a transfer of these contracts by operation of law. In cases where the insolvent undertaking could be transferred within a period of 45 days, this conflict is positively addressed and even resolved. However, the amendments did not remove these conflicts with section 197 of the LRA in general. Despite the political will to resolve the problems between section 38 of the Insolvency Act and section 197 of the LRA (1995), the amendment package only

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[502] Ahanchian AJ, Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision (2002) *Chicago-Kent Journal of International and Comparative Law*, 29, 30.

[503] Ahanchian AJ, Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision (2002) *Chicago-Kent Journal of International and Comparative Law*, 29, 59.

[504] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1840.

[505] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1860.

postponed these problems to a later date.[506] The outcome of the employment contracts, i.e. the true relation between section 38 of the Insolvency Act and sections 197, 197A of the LRA, was not sufficiently stipulated. Section 38 of the Insolvency Act is not aligned with the rest of the insolvency law framework any longer and raises a new opportunity for conflict.

With respect to the South African struggle for human rights and democracy, it was certainly a good decision to adopt the European provisions. It is evident that South Africa could learn a lot from the experiences of European jurisprudence as well as of the jurisprudences of the Member States in general. Regarding the difficulties with the wording of section 197 of the LRA, one has to keep in mind that the jurisdiction of the European Court of Justice is uncertain in a few of these matters too. In *NEHAWU v UCT*[507] *Mlambo J* stated that a uniform approach to the decisions of the European Court of Justice regarding the question whether there was a transfer as a going concern, i.e. whether the economic entity retained its identity, had proven to be "elusive"[508]. European jurisprudence has problems in answering the question whether an economic entity retains its identity. Consequently, one cannot argue that a uniform approach would lead to more certainty within South African labour law. But despite all understandable discussions regarding the judiciary of the ECJ, it is useful to define the "going concern" with the above-mentioned basket of objective indicators, as *Landman J* did in *SAMWU & others v Rand Airport Management Co.*[509] A legal definition seems to be impossible because of the need to contain numerous indicators and to apply them to the special needs of the single case. It is thus rather doubtful that the opportunity to define this term by means of the LRA was "golden", as *Boraine* and *van Eck* said.[510]

It is obvious that the interests of the stakeholders of the insolvent business concerned are different. That is why there are different legislative intentions of labour law and insolvency law. The European opinion is fundamentally in accordance with the argument of *Landman J* that the reach of the LRA will end once insolvency enters the picture.

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506 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1865.

507 (LC) in *ILJ* 2000, 1618 ff..

508 (LC) in *ILJ* 2000, 1618, 1631 (D).

509 (LC) in *BLLR* 2002, 1219 ff.

510 Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.

The inherently unequal relationship between the parties of the employment relationship and the protective nature of transfer provisions were the basis for the judgements of the South African courts that the new employer's consent would not be necessary.[511] The first consequence of an automatic transfer is that employees would not have a right to object to the transfer of their contracts. The labour courts have retained his interpretation to reject the employees' power to object. The reason for this is probably that the courts did not appreciate the framework within which these protective provisions operate.[512] The constitutionality of the South African approach to the employer's right to object is certainly doubtful. However, the implementation of the Directive 2001/23/EC to the German law went much too far, as stated *supra*.[513] The European provisions in this regard seem to reflect a good appreciation of the clashing interests. The Member States of the European Union have the above-mentioned opportunity to exclude the transferor's debts that existed prior to the transfer. § 613a BGB is applicable in cases of insolvency only with regard to the continuity of the employment and the works council, as examined *supra*. European law provides for guarantee institutions to safeguard employees' rights in the event of their employer's insolvency.

The transferee's and transferor's right to agree otherwise to a transfer of the employment contract, the lack of power to object to a transfer and the problems with disclosure of information and consultation are in many instances disadvantageous for the employees.

Despite all criticism, one has to stress that the amendment of the Insolvency Act was certainly the start of a new philosophy in insolvency law, which recognised employees' interests as well as the aim to encourage the rescue of economic entities. However, this rescue philosophy needs to be developed into a proper regime. For this development, a balance of the different interests of all stakeholders is necessary. Despite the fact that such a balance seems to be impossible, the aim of the South African law will be to pursue a clear line, i.e. that all relevant statutory provisions will be at least aligned within the South African legal framework.

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[511] Smit N, *Labour Law implications of the transfer of an undertaking*, 221.

[512] Smit N, *Labour Law implications of the transfer of an undertaking*, 233.

[513] Ahanchian AJ, Reducing the Impact of the European Union's Invisible Hand on the Economy by Limiting the Application of the Transfer of Undertakings Provision (2002) *Chicago-Kent Journal of International and Comparative Law*, 29, 54.

While it is important to protect the rights of employees and to preserve their jobs, it is arguably equally or even more important to facilitate the growth and efficiency of businesses. In 2000, in respect to the release of the amendment package, the Minister of Labour said,

> "You may attempt to label the amendments 'business friendly' or 'labour friendly'. I believe this would be a narrow-minded approach. We have made a concerted effort to ensure that these amendments will effect a change for the better for employers and employees, for the employed and the unemployed, for large and small business, for the public and the private sector."[514]

In every case the legislator should try to establish a business-friendly climate. The reduction of the extremely high South African unemployment rate cannot be achieved with ordinary protection of already existing jobs. A massive increase in the number of people in employment needs first of all a significantly increased GDP. This will certainly need an economic climate that makes South Africa a first choice for investments. Employers are always interested in markets that will be unregulated by the state. Especially the applicability of section 197 of the LRA in insolvency circumstances could discourage business people from investing. The above argument, namely that employers would be thankful for statutory regulations that make private regulations of the contracting parties in transfer matters unnecessary, might be appropriate for small businesses. Undertakings, especially undertakings operating internationally, will not require such help from the state. They always have enough legal knowledge to create all-encompassing contracts that deal with all consequences of their decisions, also in transfer of undertakings matters. Section 197 of the LRA will not work in favour of their own plans, especially because of the uncertainties and the possibility that the courts could adjust their former decisions. But if the transfer of undertakings were not statutorily regulated in insolvency circumstances, a basic standard of protection of the already employed employees as created by the unfair labour practices legislation would become more important again as required by section 23 (1) of the Constitution.

However, it is very doubtful whether it is possible to balance the different interests of all stakeholders. With Kahn-Freund one might have to conclude,

> "The fact is that every employment dispute is a manifestation of the truism that the legitimate expectations of management and labour belong to those which are inevitably in conflict."[515]

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[514] http://www.info.gov.za/speeches/2000/000727110p1004.htm.

[515] Kahn-Freund, *Labour and the Law* (1983), 66.

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Annexure

Sections 197, 197A LRA of the Labour Relations Act 12 of 2002

"197. Transfer of contract of employment.—(1) In this section and in section 197A—

(a) "business" includes the whole or a part of any business, trade, undertaking or service; and

(b) "transfer" means the transfer of a business by one employer ("the old employer") to another employer ("the new employer") as a going concern.

(2) If a transfer of a business takes place, unless otherwise agreed in terms of subsection (6)—

(*a*) the new employer is automatically substituted in the place of the old employer in respect of all contracts of employment in existence immediately before the date of transfer;

(*b*)all the rights and obligations between the old employer and an *employee* at the time of the transfer continue in force as if they had been rights and obligations between the new employer and the *employee*;

(*c*)anything done before the transfer by or in relation to the old employer, including the *dismissal* of an employee or the commission of an unfair labour practice or act of unfair discrimination, is considered to have been done by or in relation to the new employer; and

(*d*)the transfer does not interrupt an *employee's* continuity of employment, and an *employee's* contract of employment continues with the new employer as if with the old employer.

(3) (*a*) The new employer complies with subsection (2) if that employer employs transferred *employees* on terms and conditions that are on the whole not less favourable to the *employees* than those on which they were employed by the old employer.

(*b*) Paragraph (*a*) does not apply to *employees* if any of their conditions of employment are determined by a collective agreement.

(4) Subsection (2) does not prevent an employee from being transferred to a pension, provident, retirement or similar fund other than the fund to which the employee belonged prior to the transfer, if the criteria in section 14 (1) (*c*) of the Pension Funds Act, 1956 (Act No. 24 of 1956), are satisfied.

(5) (*a*) For the purposes of this subsection, the *collective agreements* and arbitration awards referred to in paragraph (*b*) are agreements and awards that bound the old employer in respect of the *employees* to be transferred, immediately before the date of transfer.

(*b*) Unless otherwise agreed in terms of subsection (6), the new employer is bound by—

(i)any arbitration award made in terms of this Act, the common law or any other law;

(ii)any *collective agreement* binding in terms of section 23; and

(iii)any *collective agreement* binding in terms of section 32 unless a commissioner acting in terms of section 62 decides otherwise.

(6) (*a*) An agreement contemplated in subsection (2) must be in writing and concluded between—

(i)either the old employer, the new employer, or the old and new employers acting jointly, on the one hand; and

(ii)the appropriate person or body referred to in section 189 (1), on the other.

(*b*) In any negotiations to conclude an agreement contemplated by paragraph (*a*), the employer or employers contemplated in subparagraph (i), must disclose to the person or body contemplated in subparagraph (ii), all relevant information that will allow it to engage effectively in the negotiations.

(*c*) Section 16 (4) to (14) applies, read with the changes required by the context, to the disclosure of information in terms of paragraph (*b*).

(7) The old employer must—

(*a*)agree with the new employer to a valuation as at the date of transfer of—

(i)the leave pay accrued to the transferred *employees* of the old employer;

(ii)the severance pay that would have been payable to the transferred *employees* of the old employer in the event of a dismissal by reason of the employer's operational requirements; and

(iii)any other payments that have accrued to the transferred *employees* but have not been paid to *employees* of the old employer;

(*b*)conclude a written agreement that specifies—

(i)which employer is liable for paying any amount referred to in paragraph (*a*), and in the case of the apportionment of liability between them, the terms of that apportionment; and

(ii)what provision has been made for any payment contemplated in paragraph (*a*) if any *employee* becomes entitled to receive a payment;

(*c*)disclose the terms of the agreement contemplated in paragraph (*b*) to each *employee* who after the transfer becomes employed by the new employer; and

(*d*)take any other measure that may be reasonable in the circumstances to ensure that adequate provision is made for any obligation on the new employer that may arise in terms of paragraph (*a*).

(8) For a period of 12 months after the date of the transfer, the old employer is jointly and severally liable with the new employer to any *employee* who becomes entitled to receive a payment contemplated in subsection (7) (*a*) as a result of the *employee's dismissal* for a reason relating to the employer's *operational requirements* or the employer's liquidation or sequestration, unless the old employer is able to show that it has complied with the provisions of this section.

(9) The old and new employer are jointly and severally liable in respect of any claim concerning any term or condition of employment that arose prior to the transfer.

(10) This section does not affect the liability of any person to be prosecuted for, convicted of, and sentenced for, any offence.

197A. Transfer of contract of employment in circumstances of insolvency.—

(1) This section applies to a transfer of a business—

(*a*)if the old employer is insolvent; or

(*b*)if a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency.

(2) Despite the Insolvency Act, 1936 (Act No. 24 of 1936), if a transfer of a business takes place in the circumstances contemplated in subsection (1), unless otherwise agreed in terms of section 197 (6)—

(*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;

(*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.

(3) Section 197 (3), (4), (5) and (10) applies to a transfer in terms of this section and any reference to an agreement in that section must be read as a reference to an agreement contemplated in section 197 (6).

(4) Section 197 (5) applies to a *collective agreement* or arbitration binding on the employer immediately before the employer's provisional winding-up or sequestration.

(5) Section 197 (7), (8) and (9) does not apply to a transfer in accordance with this section.

Section 38 Insolvency Act as implemented on 1st January 2003

"Contract of employment suspended on insolvency of employer"

38. (1) The contracts of service of employees whose employer has been sequestrated are suspended with effect from the date of the granting of a sequestration order.

(2) Without limiting subsection (1), during the period of suspension of a contract of service referred to in subsection (1)—

(a) an employee whose contract is suspended is not required to render services in terms of the contract and is not entitled to any remuneration in terms of the contract; and

(b) no employment benefit accrues to an employee arising out of any contract of service that is suspended.

(3) An employee whose contract of service is suspended is deemed to be employed for the purposes of the Unemployment Insurance Act, 1966 (Act No. 30 of 1966), from the date of such suspension and, subject to the provisions of that Act, is entitled to receive unemployment benefits in terms of section 35 of that Act.

(4) An employee whose contract of service has been—

(a) suspended in terms of subsection (1); or

(b) terminated in terms of subsection (5) or (10),

is entitled to claim compensation from the insolvent estate of his or her former employer for loss suffered by reason of the suspension or termination of a contact of service prior to its expiration.

(5) A trustee appointed in terms of this Act may terminate the contracts of service of employees, subject to subsection (6) and (8).

(6) A trustee may not terminate a contract of service unless the trustee has consulted with—

(a) any person who the insolvent employer was required to consult with, immediately before the sequestration, in terms of a collective agreement defined in section 213 of the Labour Relations Act, 1995 (Act No. 66 of 1995);

(b) a workplace forum defined in section 213 of the Labour Relations Act (1995) if there is no such collective agreement, that existed immediately prior to the sequestration;

(c) a registered trade union representing employees whose contracts of service were suspended in terms of subsection (1) and who are likely to be affected by the termination of the contract of service, if there is no such workplace forum; or

(d) the employees whose contracts of service were suspended in terms of subsection (1) and who are likely to be affected by the termination of the contract of service or their representatives nominated for that purpose, if there is no such trade union.

(7) The consultation referred to in subsection (6) must seek to reach 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 (Act No. 61 of 1973) or;

(d) in any other manner.

(8) If any party referred to in subsection (6), wishes to make proposals concerning any matter contemplated in subsection (7), that party must submit written proposals to the trustee within 21 days of the appointment of the trustee in terms of section 56, unless the trustee and an employee agree otherwise.

(9) A creditor of the insolvent employer may, with the consent of the trustee, participate in any consultation contemplated in this section.

(10) All suspended contracts of service shall, subject to measures contemplated in subsection (7), terminate 45 days after the date of the appointment of a trustee in terms of section 56.

(11) An employee whose contract of service terminates or has been terminated in terms of this section is entitled to claim severance benefits from the estate of the insolvent employer in accordance with section 41 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997).".