THE JOB SECURITY OF EMPLOYEES OF FINANCIALLY DISTRESSED COMPANIES

MIEKA E. LOUBSER*
BAccLLB candidate, Faculty of Law, Stellenbosch University

CHRISTOPH GARBERS**
Associate Professor, Faculty of Law, Stellenbosch University

Abstract

This contribution considers the legislative regulation of the job security (which boils down to preservation of employment) of employees in case of financial distress of a company. It juxtaposes the legislative regulation of four interrelated processes a company may engage in where it finds itself in financial distress, namely a voluntary internal restructuring (especially retrenchment), the transfer of the business or part of the business, business rescue and winding up. The legislative endeavour to preserve the job security of employees in all these processes is described and analysed. The discussion shows that room exists for companies to circumvent this protection and, to the extent that the protection does apply, that it remains difficult for employees to ultimately challenge the substance of decisions negatively affecting their job security. The main protection for employees in all these processes is procedural in nature and to be found in their rights to be informed of and consulted prior to decisions negatively affecting them. In this regard, business rescue is the most employee-friendly process. Participation in this process by employees, however, requires a fine balance as it may be self-defeating and lead to winding up and the permanent loss of jobs.

Keywords: *dismissal; operational requirements; retrenchment; transfer of a business; business rescue; merger; insolvency; liquidation*

* BAccLLB candidate, Faculty of Law, Stellenbosch University.

** BLC LLB (UP) B Com (Hons) (UNISA) LLM (US). This paper is a revised and expanded version of a dissertation written by the first author under the supervision of the second author. The authors would like to thank PAK le Roux and Prof Richard Stevens for their comments. Mistakes remain our own.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

I INTRODUCTION

This article explores the job security of employees of a company in financial distress. Job security means protection against a downward adjustment in terms and conditions of employment as well as protection against loss of employment. The topic is of particular importance for at least three reasons. First, from the perspective of employees, continued job security equates to the protection of their livelihood. Secondly, any protection of employees runs the ever-present risk of being counterproductive in contributing to the survival of companies in the face of financial distress. If too much protection is afforded to the employees of the company, not only will entrepreneurs be disincentivised to enter the market, but it may stifle the survival of companies facing financial distress. Thirdly, against the backdrop of an already sluggish economy, the Covid-19 pandemic has wreaked havoc and placed numerous companies in financial distress and endangered the job security of many employees. Recent statistics show, for example, that between April 2020 and October 2020, 233 business rescue proceedings were instituted in relation to companies in financial distress, of which two have already ended in liquidation.[1] Liquidations in South Africa increased by 21.5 per cent for the seven-month period between January and July 2021 compared to the same period in 2020.[2] From the perspective of employees, the prevalence of financial distress across the economy is reflected in the increase in dismissals of employees based on operational requirements. For example, in August 2020, the Department of Employment and Labour reported that in the preceding month alone, the Commission for Conciliation, Mediation and Arbitration (the 'CCMA') received 190 large-scale retrenchment referrals and 1 307 small-scale retrenchment referrals.[3] With the pandemic showing few signs of abating, this trend is likely to continue into the future.

[1] Companies and Intellectual Properties Commission, 'Business Rescue Proceedings Status Report — as at 31 October 2020', available at http://www.cipc.co.za/files/3616/0490/5024/Status_of_Business_Rescue_Proceedings_in_South_Africa_-_as_at_31_October_2020_v1.0.pdf, accessed on 26 August 2021.

[2] Statistics South Africa, 'Statistical Release P0043—Statistics of liquidations and insolvencies, July 2021', available at http://www.statssa.gov.za/?page_id=1856&PPN=P0043&SCH=72854, accessed on 26 August 2021.

[3] Mlamla, 'Retrenchment referrals pour in for the CCMA' *Independent Online* 12 August 2020, available at https://www.iol.co.za/capeargus/news/retrenchment-referrals-pour-in-for-the-ccma-b7ffeeb3-feda-44ba-b64b-cf8d515d3b6a, accessed on 26 August 2021. Not surprisingly, the pandemic has exacerbated the already high levels of unemployment in South Africa. Unemployment in the second quarter of 2021 increased by 584 000 people to 7.8 million unemployed persons just from the levels experienced during the first quarter of 2021. This resulted in a 1.8 per cent increase in the official unemployment rate to 34.4 per cent, which is the highest unemployment rate 'since the start of the QLFS (Quarterly Labour Force Survey) in 2008'. Furthermore, 8.1 per cent of employees in South Africa lost their jobs during

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

The financial distress of a company may trigger any one, or a combination, of a variety of processes — some voluntary, some compulsory, some with retention of control by the company and others not, and some more beneficial than others to existing employees. While a company in financial distress often will try to raise capital or engage in financial restructuring to ensure its survival, this article will assume — as will in reality often be the case, that the company in question cannot do so. This essentially leaves four (overlapping) avenues open to that company which may be listed in ascending order of external intervention and finality: voluntary internal restructuring (which will often involve a downward adjustment of the terms and conditions of employment of employees and/or a reduction of the workforce through dismissal for operational reasons in terms of the Labour Relations Act 66 of 1995 ('the LRA')),[4] the sale and subsequent transfer of the business of the company (or part thereof) to third parties, business rescue and winding up. Of these, winding-up may be described as the most invasive, at least in the sense that it will result in dissolution and deregistration of the company and the complete and permanent job losses for employees. The other processes leave room for continued survival, albeit typically accompanied by some form of internal restructuring (inclusive of the dismissal of employees based on the company's operational reasons).

The purpose of this paper, then, is to reflect on the job security of employees of a company in financial distress by sequentially considering the legislative provisions impacting on a voluntary internal restructuring (Part II), the transfer of a business or a part of a business (Part III), business rescue (Part IV), winding up (Part V), and conclusion (Part VI).

This paper focuses on the legislative protection of employees only (and not the common-law protection of employees) and recognises the

the first six weeks of the Covid-19 lockdown. Of those who lost their jobs, 1.4 per cent became unemployed. Note that all unemployment data are based on the narrow definition of unemployment being workers aged 15–64 who are unemployed, but actively looking for work and available to work or unemployed and not actively looking for work but are set to start working at a future date. See Statistics South Africa, 'Statistical Release P0211—Quarterly Labour Force Survey, 2nd Quarter 2021', available at http://www.statssa.gov.za/?page_id=1854&PPN=P0211&SCH=72944, accessed on 26 August 2021 and Statistics South Africa, 'Report-00–80–03—Results from Wave 2 survey on the impact of the COVID-19 pandemic on employment and income in South Africa', available at http://www.statssa.gov.za/?page_id=1854&PPN=Report-00–80–03&SCH=72638, accessed on 26 August 2021.

[4] Section 188 of the LRA recognises the right of an employer to dismiss based on 'operational requirements'. In turn, s 213 defines 'operational requirements' as the 'economic, technological, structural or similar reasons of an employer'. In case of financial distress, a possible dismissal will clearly be based on either, or a combination, of the 'economic' and 'structural' reasons of the employer.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

fact that the legislative protection of employees in the context of financial distress of the employer draws together insights from labour law, company law, insolvency law and competition law.

It should be noted that the fact that employees retain their common-law contractual remedies to ensure their protection despite legislative attempts to achieve the same outcome, was recently reaffirmed by our highest court in *Baloyi v Public Protector & others.*[5] However, the protection offered by the common law largely is a chimaera. For the individual employee, the successful pursuit of a contractual remedy to challenge employer conduct short of dismissal depends, in the first instance, on the wording of the employment contract[6] and, secondly, on a host of other factors that militate against its use.[7] Against dismissal itself, reliance on the employment contract offers virtually no protection,[8] an ever-present threat that also reflects back on the willingness of employees to use the common law to challenge proposed employer conduct short of dismissal. At the same time, the individual nature of the employment contract and the absence of common-law protection against dismissal leave no room for reliance on collective action by employees to force the hand of an employer, even less so where the

[5] (2021) 42 *ILJ* 961 (CC).

[6] Garbers et al, *The New Essential Labour Law* 7 ed (Mace Labour Law Publications 2019) 275 explain as follows: 'the common law duties of employees are fairly vaguely defined and most contracts of employment take the same approach. This enables the employer to argue that it has the contractual right to introduce changes to the way in which work is performed (e.g. changing the duties, or the hours of work, of an employee). Even if the contract of employment prevents the employer from introducing the change without the employee's consent, the employer will be able simply to terminate employment by giving notice of termination of employment and offering to re-employ the employee on the new terms and conditions of employment, or hiring employees who are willing to work in terms of the new contract.' See also *Skinner & others v Nampak Products Limited & others* (JA95/19) [2020] ZALAC 43 (24 November 2020).

[7] On the assumption that a contractual right existed and was breached, pursuit of a contractual remedy is influenced by jurisdiction (largely reserved for the Labour Court or civil courts) and concomitant considerations of, for example, time and cost.

[8] Garbers et al, (Mace Labour Law Publications 2019) 275 make the following remarks: 'Traditional common law principles permit an employer to introduce these changes with relative ease. An employer needing to reduce its workforce can terminate contracts of employment entered into for an indefinite period of time by giving notice of termination of employment. If the contract of employment is for a fixed period of time, the employer's right to terminate employment during the period of validity of the contract will be limited, unless the employer has contracted to permit it to terminate employment by giving notice during the course of the fixed-term contract. But even if there is no such provision most fixed-term contracts will not be concluded for long periods of time. If proper notice of termination is given, or if a fixed-term contract terminates due to the effluxion of time, these terminations are lawful.'

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

collective action is aimed at the pursuit of a mere 'interest'[9] and not an enforcement of an existing contractual right.[10]

This paper attempts to bring together insights from different branches of law, too often considered in isolation from each other. While this paper endeavours to identify insights from this broad enquiry, it is submitted that the mere juxtaposition of these branches of law and their impact already has value and hopefully will stimulate further debate about the quality of protection of employees of financially distressed companies. However, such a study does create challenges and at least requires careful further articulation of terminology before it is embarked on. In this regard, the term 'employee(s)'[11] will be used in the broadest sense of the word to denote the employees themselves, trade unions and trade union representatives (unless the context requires specification). The focus in this contribution is on the financial position of a company registered or converted as such in terms of the Companies Act 61 of 1973 ('the 1973 Act') or the Companies Act 71 of 2008 ('the 2008 Act').[12] For obvious reasons, 'company' and 'employer' will be used interchangeably. As purposed for this paper, a company will be regarded as already 'financially distressed' even if it is solvent but approaching commercial insolvency[13] in the sense that it is struggling to pay its debts

[9] A distinction is often drawn between disputes of right (disputes about the existence, interpretation or application of a right) and disputes of interest (disputes about the creation of a new right) – see Garbers et al, (Mace Labour Law Publications 2019) 507. Where changes to terms and conditions are at stake, the dispute is about creation of a new right (i.e. an interest dispute). While the Constitution of the Republic of South Africa, 1996 (the Constitution) (in s 23(5) through the right to engage in collective bargaining) and the Labour Relations Act 66 of 1995 (LRA) (through its promotion of the process of collective bargaining) provide a whole system for the collective processing of interest disputes, this is not the case with the common law.

[10] As will become clear from the discussion in Part II below, even consideration of the legislative protection of employees in case of the financial distress of companies reduces itself in practice to a consideration of protection against dismissal and not so much protection against a downward adjustment in terms and conditions of employment (which is easily justifiable in this context).

[11] For purposes of this paper, the term 'employee' will simply be used as defined in s 213 of the LRA: '(a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and (b) any other person who in any manner assists in carrying on or conducting the business of an employer...'. For a discussion of the meaning of this definition, see Garbers et al, (Mace Labour Law Publications 2019) 64–80.

[12] A company is defined as a juristic person, with limited liability (s 19(2) of the Companies Act 71 of 2008), which is registered in terms of the Companies Act 61 of 1973 ('the 1973 Act') or the Companies Act 71 of 2008 ('the 2008 Act') or which has been converted to a company in terms of the 2008 Act (s 1 of the 2008 Act).

[13] Commercial solvency (also called 'the cash flow test') means that a company is able to pay its debts in the ordinary course of business. In contrast, factual solvency, known as the balance-sheet test, means that the company's assets exceed its liabilities. See Delport (ed), *Henochsberg on the Companies Act 71 of 2008* (LexisNexis 2019) 457; MF Cassim,

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

or just foresees such a possibility. Mindful of the specific meanings ascribed by legislation to the terms 'financially distressed'[14] and 'insolvency'[15] as preconditions for the processes of business rescue and winding up respectively, this initial broad view of 'financially distressed' may already trigger the first two processes (voluntary internal restructuring and a transfer of (a part of) the business). Moreover, 'liquidation' and 'winding up' will carry the same meaning and, finally, the term 'retrenchment' will be used interchangeably with the phrase 'dismissal for operational requirements'.

II VOLUNTARY INTERNAL RESTRUCTURING

Voluntary internal restructuring which affects both dimensions of the job security of employees, is an option that may be available to a company in financial distress but requires compliance with the LRA. As far as potential changes to the terms and conditions of employment of employees are concerned, however, the legislative protection of employees is more apparent than real. For the individual employee, the use of a number of the unfair labour practice provisions in the LRA to challenge a downward adjustment in terms and conditions of employment is possible at face value.[16] There are, however, two almost insurmountable obstacles to challenges aimed at the conduct of the employer on this basis. First, the 'unfair labour practice' is designed to address justiciable rights disputes rather than interest disputes.[17] In essence, any dispute about a potential reduction in terms and conditions of employment remains a non-justiciable interest dispute.

'South African Airways makes an emergency landing into business rescue: some burning issues' (2020) 137 *SALJ* 201 at 208; *Boschpoort Ondernemings (Pty) Ltd v ABSA Bank Ltd* 2014 (2) SA 518 (SCA) para 21.

[14] See the discussion of business rescue in Part IV below.

[15] See the discussion of winding up in Part V below.

[16] Section 186(2) of the LRA declares, for example, unfair conduct relating to demotion and unfair conduct relating to the provision of benefits to be unfair labour practices.

[17] It is noteworthy that in *Apollo Tyres SA (Pty) Ltd v Commission for Conciliation, Mediation & Arbitration & others* (2013) 34 *ILJ* 1120 (LAC) the Labour Appeal Court adopted a broad interpretation of 'benefits' in the definition of an unfair labour practice by holding (para 50) that a 'benefit' is 'a right or entitlement to which an employee is entitled (ex contractu or ex lege including rights judicially created) as well as an advantage or privilege which has been offered or granted to an employee in terms of a policy or practice subject to the employer's discretion'. As such, the court extended the meaning of 'benefit' beyond pre-existing rights. Even so, this approach still, at least, requires a pre-existing policy or practice adopted by the employer. And even where a proposed downward change of terms and conditions of employment results in a reduction or elimination of benefits within the extended meaning of the term 'benefit', this does not mean the employer's conduct, especially in times of financial distress, will be unfair.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

Secondly, even if the dispute passes this jurisdictional hurdle, the conduct of the employer has to be found to be unfair. In the case of the pre-existing financial distress of a company and as alternatives to a potential dismissal, measures short of dismissal imposed by the employer will, more likely than not, be found to be fair. Furthermore, even though labour legislation actively promotes collective bargaining about interest disputes, the possible use of collective action by employees to combat a downward adjustment in terms and conditions of employment in this context is severely curtailed, both as a matter of good sense and as a matter of law. While a strike about changes to terms and conditions of employment is always a possibility, it is simply a foolhardy option in times of pre-existing financial distress, an option that may well culminate in a fair dismissal. It should be noted that should there be a dismissal, and with one notable exception,[18] strikes about matters that may be referred to arbitration or the Labour Court (the 'LC') (such as unfair dismissal) are unprotected.[19] All of this means that the main protection of employees in case of voluntary restructuring by the employer is found in a combination of the substantive and procedural protection against unfair dismissal in terms of the LRA (also applicable to all the other processes discussed in this article).

In this regard, the LRA contains four layers of protection. First, on top of obvious instances of dismissal,[20] the extended definition of dismissal in the LRA may already open the door for wider protection of employees where, for example, an employer in financial distress seeks to shed fixed-term employees first.[21] Secondly, s 187 of the LRA provides for nine reasons that make a dismissal automatically unfair. Three of these reasons are particularly relevant where an employer seeks to rely on its operational requirements to restructure the workplace in times of financial distress in the face of employee resistance — dismissal for participation in a protected strike against the proposed changes,[22] dismissal for a refusal to accept a demand about a matter of mutual interest (the proposed changes being such a matter of mutual interest)[23] and dismissal on account of a s 197 LRA transfer[24] (or a reason

[18] Section 189A(7)–(12) of the LRA allows for strike action about the substantive fairness of a large-scale retrenchment.

[19] Section 65(1)*(c)*.

[20] Where the employer simply terminates employment with notice as envisaged by s 186(1)*(a)* of the LRA.

[21] 'Dismissal' is given and extended meaning in s 186(1)*(b)–(f)* of the LRA, including the non-renewal of fixed-term contracts under the circumstances envisaged by s 186(1)*(b)*.

[22] Section 187(1)*(a)* of the LRA.

[23] Section 187(1)*(c)*.

[24] Section 187(1)*(g)*. See the discussion in Part III below.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

related to such a transfer). Thirdly, even if a dismissal is found not to be automatically unfair, the dismissal still has to be substantively fair (for a fair reason related to operational requirements)[25] and procedurally fair, with the latter encapsulating the (pre-dismissal) audi alteram partem principle.[26] Fourthly, should a dismissal be found to be unfair (automatic or otherwise), the primary remedies are reinstatement or re-employment,[27] that is, a post-dismissal resurrection and preservation of employment. However, these two remedies are limited to findings of substantive unfairness and do not extend to findings of procedural unfairness only.[28] The discussion below will focus on the quality of protection of employees of financially distressed companies against automatically unfair dismissal and against unfair dismissal based on operational requirements.

(a) Protection of employees against automatically unfair dismissal where the employer relies on operational requirements to dismiss

Reliance by employees on an allegation of automatically unfair dismissal where the employer retrenched them, requires, in the first instance, determination of the 'probable' reason for the dismissal — whether the reason for dismissal is the alleged automatically unfair reason on which the employees rely or the potentially fair reason, in our case operational requirements, on which the employer relies. One approach to the determination of this issue was formulated as follows by the Labour Appeal Court (the 'LAC') in *South African Chemical Workers Union v Afrox Limited* ('*Afrox*')[29] in the context of the dismissal of protected strikers who went on strike in opposition to an adjustment to their terms and conditions of employment and the employer's ultimate decision to outsource the services in question:[30]

> 'The enquiry into the reason for the dismissal is an objective one, where the employer's motive for the dismissal will merely be one of a number of factors to be considered. This issue (the reason for the dismissal) is essentially one of causation and I can see no reason why the usual twofold approach to causation, applied in other fields of law, should not also be utilised here.... The first step is to determine *factual* causation: was

[25] Section 188(1)*(a)*(ii) of the LRA.

[26] Section 188(1) of the LRA; see also Van Eck, Boraine & Steyn, 'Fair Labour Practices in South African Insolvency Law' (2004) 121 *SALJ* 902 at 907.

[27] Section 193(1) of the LRA.

[28] Section 193(2).

[29] (1999) 20 *ILJ* 1718 (LAC).

[30] In other words, for purposes of application of s 187(1)*(a)* of the LRA.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

> participation or support, or intended participation or support, of the protected strike a sine qua non (or prerequisite) for the dismissal? Put another way, would the dismissal have occurred if there was no participation or support of the strike? If the answer is yes, then the dismissal was not automatically unfair. If the answer is no, that does not immediately render the dismissal automatically unfair; the next issue is one of *legal* causation, namely whether such participation or conduct was the 'main' or 'dominant', or 'proximate', or 'most likely' cause of the dismissal. There are no hard and fast rules to determine the question of legal causation... . I would respectfully venture to suggest that the most practical way of approaching the issue would be to determine what the most probable inference is that may be drawn from the established facts as a cause of the dismissal, in much the same way as the most probable or plausible inference is drawn from circumstantial evidence in civil cases. ... . Only if this test of legal causation also shows that the most probable cause for the dismissal was only participation or support of the protected strike, can it be said that the dismissal was automatically unfair.'[31]

Recently, in *National Union of Metalworkers of SA & others v Aveng Trident Steel (A Division of Aveng Africa) (Pty) Ltd & another*,[32] the Constitutional Court was split on whether the above-quoted '*Afrox* approach' should be adopted in the context of s 187(1)*(c)* of the LRA, that is, in the context of an allegation that retrenched employees were dismissed for refusing to accept the employer's demand about a matter of mutual interest, in the form of an adjustment to their terms and conditions of employment. Five members of the court adopted the approach laid down in *Afrox*,[33] while five expressly rejected it and favoured a probability-based evaluation of evidence.[34] For present purposes, it is submitted that not much hinges on this difference in approach.[35] It should also be mentioned that the *Afrox* approach had earlier been adopted by the LAC (first in *Business and Design Software*

[31] *Afrox* para 32.

[32] (2021) 42 *ILJ* 67 (CC).

[33] The judgment of Mathopo AJ (Mogoeng CJ, Khampepe J, Madlanga J and Theron J concurring).

[34] Majiedt J (Jafta J, Mhlantla J, Tshiqi J and Victor AJ concurring) expressly rejected the *Afrox* causation approach and laid down the following approach in para 119: 'The determination of the true reason for the dismissal appears to me to be simply a matter of fact, which is established in accordance with the rules applicable to the evaluation of evidence. Where an employee proffers a contrary version regarding the true reason for the dismissal, a court must resolve the dispute of fact by evaluating the evidence and by making a finding as to which of the two versions is to be preferred on a preponderance of probabilities, and why.' It is interesting to note that the judgment in *Afrox* clearly envisaged both approaches and also to note that Majiedt J did not stray beyond s 187(1)*(c)* in his judgment.

[35] Not surprisingly, in *Aveng* both judgments (even though ostensibly using different approaches) had the same result.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

(Pty) Ltd & another v Van der Velde[36] and later in *Long v Prism Holdings*[37]) in relation to an allegation that a retrenched employee was automatically unfairly dismissed in the context of the transfer of a business.[38]

The facts in both *Afrox* and *Aveng* serve to illustrate the important point to be made. In *Afrox* the protected strike which formed the basis of the allegation of automatically unfair dismissal took place against the backdrop of a long history of changed operational requirements and fruitless consultation and negotiation about changes to employees' terms and conditions of employment and the subsequent outsourcing of services rendered by some employees.[39] Similarly, the dismissals in *Aveng* originated in harsh economic conditions, followed by a lengthy process of consultation, ostensible agreement with the union and the ultimate refusal of some employees to work under changed circumstances.[40] The point simply is this: circumstances of the kind that cause financial distress to companies rarely arise overnight and will always precede the potentially automatically unfair reasons for dismissal envisaged by s 187 of the LRA — a protected strike, a refusal to agree to the employer's proposals for change or a transfer of the business or part of the business. Given this reality, as well as the consultation requirements for a procedurally fair dismissal for operational requirements (discussed

[36] (2009) 30 *ILJ* 1277 (LAC).

[37] (2012) 33 *ILJ* 1402 (LAC).

[38] In other words, for purposes of the application of s 187(1)*(g)* of the LRA. While the court in *Van der Velde* did not deal with causation in so many words, the *Afrox* approach is evident. Consider the remarks at para 34: 'the fact that the appellants said that the respondent was dismissed for the second appellant's operational requirements is significant in that it provides the link between the transfer of the first appellant's business to the second appellant and the respondent's dismissal. In the absence of the transfer of the first appellant's business to the second appellant, the second appellant's operational requirements could have nothing to do with the respondent's continued employment or dismissal. It provides a basis for the conclusion that the respondent's dismissal was for a reason that is related to the transfer of the first appellant's business to the second appellant.' In *Long* the court expressly linked the enquiry for purposes of s 187(1)*(g)* to *Afrox* at para 35: 'In order to determine whether section 197 applies, the question that has to be asked is whether the probable cause of the dismissal was the transfer of the business as a going concern, or a reason related to such transfer. See: *SA Chemical Workers Union and Others v Afrox Ltd*.'

[39] See *Afrox* paras 6–16.

[40] The court described the origin of the employer's decision as follows at para 5: 'During April 2014, as a result of harsh economic conditions, Aveng experienced a decline in sales and profitability. To maintain its profitability, it had to reduce its increasing costs, especially in relation to labour, electricity, and transport. The drop in the volume of sales meant that some of the machines were under-utilised. This necessitated the alignment of Aveng's workforce and production output with the market conditions. Aveng soon realised that it could no longer continue with its business model and resorted to restructuring its business in order to survive.' The dismissal in question took effect some seven months later after extensive consultation with employees.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

below) and the *Afrox* and *Aveng* approaches to the application of s 187 of the LRA (whether it is referred to as 'causation' or a 'probable reason' approach), it simply is difficult to see successful reliance on s 187 in the face of bona fide dismissals for operational requirements in times of pre-existing financial distress. Put differently, s 187 may work well in the face of ostensible misconduct and incapacity dismissals and perhaps even in case of dismissals for operational reasons where restructuring is aimed at, for example, the increase in profits of a financially sound company, but not where the bona fide operational requirements of the employer result in dismissal to ensure the survival of the company. One qualification to this statement is perhaps to be found in the wide wording of s 187(1)*(g)* of the LRA — which states that a dismissal is automatically unfair if the reason for the dismissal is a section 197 transfer, *or any reason related to such a transfer*. This provision may provide relatively more security to employees than the other two relevant provisions of s 187 of the LRA mentioned above.[41] At the same time, exactly because of the broad wording of s 187(1)*(g)* of the LRA, it may significantly detract from the attractiveness of business transfers to ensure a company's survival – either on its own, or in conjunction with internal restructuring, business rescue proceedings or liquidation proceedings (as discussed below).

But even if it is difficult to envisage successful reliance on s 187 of the LRA in case of financial distress of a company, the LRA endeavours to add another layer of protection by requiring retrenchments, through s 188 of the LRA, to be both substantively and procedurally fair in those cases where the reason for the dismissal is not one of the automatically unfair reasons in s 187 of the LRA.

(b) The protection of employees against unfair retrenchment

Where only the fairness of the retrenchment as such (and not its possible automatic unfairness) is at stake, the difficulty for employees has always been to successfully challenge the substantive fairness of a retrenchment,[42] also bearing in mind that it is only a finding of substantive unfairness that can lead to the reinstatement of an employee. Given the reality that courts are not best placed to run businesses, certainly not

[41] Dismissal for participation in a protected strike in opposition to proposed changes (s 187(1)*(a)* of the LRA) or dismissal for the mere refusal (absent a strike) to accept the proposed changes (s 187(1)*(c)* of the LRA).

[42] See Du Toit, 'Business Restructuring and Operational Requirement Dismissals: Algorax and Beyond' (2005) 26 *Indus LJ* 595 at 602 and Cohen, 'Unfair dismissal' in Du Toit et al, *Labour Relations Law – A Comprehensive Guide* 6 ed (LexisNexis 2015) 473–480 for the development of substantive fairness.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

with perfect hindsight once the dispute comes before them (often long after the fact), South African jurisprudence tells a tale of fluctuating judicial approaches to assessing the substantive fairness of retrenchments. For purposes of this discussion, the tale starts with *SACTWU & another v Discreto* ('*Discreto*')[43] where the LAC held that the function of the court in determining whether retrenchment is fair or not is not to 'second guess' the decision of the employer, but rather to enquire whether the decision was rationally connected to commercially sound reasons for restructuring, having regard to what emerged during the consultation process.[44]

This 'deferential' approach adopted in *Discreto* — which also found its way for some time into the LRA,[45] has been criticised for 'equating rationality with fairness'.[46] Both *BMD Knitting Mills (Pty) Ltd v SACTWU* ('*BMD Knitting Mills*')[47] and *CWIU & others v Algorax (Pty) Ltd* ('*Algorax*')[48] subsequently sought to qualify *Discreto*. *BMD Knitting Mills* held that 'fairness' requires the court not only to examine the commercial justification for the dismissal, but also to enquire whether the dismissal is reasonable.[49] *Algorax* further held that 'fairness' is determined objectively.[50] As Bosch argues, both these cases sought to emphasise that an employer has to balance continuation of the company as a going concern with the employee's right to fair dismissal and that rationality could not be the basis for fairness.[51] Du Toit points out that the further implication of *BMD Knitting Mills* and *Algorax* may be that a company's dismissal of an employee for operational requirements has to be a necessary decision as opposed to a decision based on business efficiency in order to be regarded as fair.[52]

In *SATAWU v Old Mutual Life Assurance Co SA Ltd*[53] the LC attempted to reconcile the rationality approach in *Discreto* with the approach of *BMD Knitting Mills*. Murphy AJ stated that there should be

[43] (1998) 12 BLLR 1228 (LAC). For earlier cases, see *Môrester Bande (Pty) Ltd v National Union of Metalworkers of SA & another* (1990) 11 *ILJ* 687 (LAC), *Seven Abel CC t/a The Crest Hotel v Hotel & Restaurant Workers Union & others* (1990) 11 *ILJ* 504 (LAC) and *National Union of Metalworkers of SA v Atlantis Diesel Engines (Pty) Ltd* (1993) 14 *ILJ* 642 (LAC).

[44] *Discreto* para 8.

[45] In s 189A(19) of the LRA (since repealed) in respect of large-scale retrenchments.

[46] Bosch, 'Operational requirements dismissals and section 197 of the Labour Relations Act: Problems and possibilities' (2002) 23 *ILJ* 641 at 643.

[47] (2001) 7 BLLR 705 (LAC).

[48] (2003) 11 BLLR 1081 (LAC).

[49] *BMD Knitting Mills* para 19.

[50] *Algorax* para 69.

[51] Bosch, (2002) 23 *ILJ* 641 at 643.

[52] Du Toit, (2005) 26 *ILJ* 595 at 604.

[53] (2005) 4 BLLR 378 (LC).

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

a rational connection between the decision to dismiss and the company's commercial objectives, which to some extent allows the court to still consider the employer's logic. Thereafter the court should question whether the decision was fair by considering various reasonable alternatives to realising the company's commercial objectives. If restructuring was the least harmful alternative to the body of employees, although not necessarily the least drastic measure, the dismissal is fair.[54] This approach is flexible and incorporates both rationality, reasonableness and, ultimately, fairness. In *Fry's Metals (Pty) Ltd v NUMSA & others*[55] Zondo JP held that dismissal for operational requirements in order to increase profit is permissible. Essentially, Zondo JP subverted the notion that dismissal has to be a necessity to be fair.[56] This decision was confirmed by the Supreme Court of Appeal (the 'SCA').[57] More recently, in *Havemann v Secequip (Pty) Ltd*,[58] the LAC again attempted to reconcile the different approaches discussed above by stating that a fair reason for retrenchment is one that is bona fide and rationally justified and informed by a proper and valid commercial or business rationale. The court is not called on to decide whether the reason advanced by the employer is one which the court would have chosen, but whether the reason advanced is found to be fair, when considered objectively.[59] Where alternatives to the dismissal of employees exist, these are to be considered in a meaningful fashion during the consultation process preceding dismissal. Ultimately, fairness requires the solution which preserves jobs in preference to a decision that does not.[60]

These developments (and their outcome) have been described as follows:

> 'The imprecision of these tests and the conflicting approaches over the years creates some uncertainty. However, two points must be made in this regard. The first is that even, on the least strict approach, it is still necessary for the employer to lead evidence and to motivate why it had an operational need to dismiss. The employer's simple 'say so' will not be sufficient. Secondly, even the strictest approach still accepts that managerial decisions and motivations must be given due regard.'[61]

Put differently, it seems as if the substantive fairness of a retrenchment,

[54] Paragraph 85.
[55] (2003) 2 BLLR 140 (LAC).
[56] Du Toit, (2005) 26 *ILJ* 595 at 606.
[57] Confirmed in *NUMSA & others v Fry's Metals (Pty) Ltd* (2005) 5 BLLR 430 (SCA).
[58] (JA91/2014) [2016] ZALAC 53 (22 November 2016).
[59] Paragraph 28.
[60] Paragraph 33.
[61] Garbers et al, (Mace Labour Law Publications 2019) 282.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

which aims to balance rather than exacerbate the existing tension between employers and employees,[62] is a flexible concept and is found somewhere on the spectrum between rationality and reasonableness.[63] Substantive fairness is also context-specific, with the context largely defined by the consultation process preceding the dismissal. It furthermore leans in favour of job preservation. But the point to be made is that it remains difficult to challenge the substantive fairness of a retrenchment successfully, especially in cases of financial distress of the employer. Unless a clear alternative short of dismissal (or limiting dismissal) jumps out at the court from the consultation process preceding dismissal *and* the court feels comfortable in a retrospective imposition of this alternative on the employer, the challenge will be unsuccessful. Again, much as in the case of the protection against automatically unfair dismissal discussed above, the protection of employees against retrenchment is more apparent than real, more so in circumstances of financial distress.

At the same time, however, dismissals based on operational requirements must be procedurally fair. This requires adherence to the section 189 LRA process and also the section 189A LRA process if the stipulated criteria for a large-scale retrenchment by a large employer are met.[64] The process is primarily[65] aimed at effective consultation between the employer and its employees[66] to explore alternatives to retrenchment. The LAC has described the process as follows:

> 'all these primary formal obligations of an employer are geared to a specific purpose, namely to attempt to reach consensus on the objects listed in section 189(2). The ultimate purpose of section 189 is thus to achieve *a joint consensus seeking process*. In this manner the section implicitly recognizes the employer's right to dismiss for operational reasons, but then only if a fair process aimed at achieving consensus has failed. ... . The important implication of this is that a mechanical, ''checklist'' kind of approach to determine whether section 189 has been complied with is inappropriate. The proper approach is to ascertain whether the purpose of the section (the occurrence of a joint consensus seeking process) has been

[62] *Sidumo v Rustenburg Platinum Mines Ltd* 2008 (2) SA 24 (CC) para 74.
[63] Du Toit, (2005) 26 *ILJ* 595 at 611.
[64] See s 189A(1) of the LRA.
[65] Section 189(2) of the LRA requires consultation on appropriate measures to avoid dismissal, to minimise the number of dismissals, to change the timing of the dismissals, to mitigate the adverse effects of the dismissals as well as consultation on the method for selecting the employees to be dismissed and the severance pay for dismissed employees.
[66] Section 189(1).

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

achieved... . If that purpose is achieved, there has been proper compliance with the section.'[67]

In the context of retrenchment, the requirement of procedural fairness provides the opportunity for employees to influence the employer's proposed decision to dismiss. Furthermore, as discussed above, the link between substantive and procedural fairness in the context of retrenchment is important.[68] In fact, the LAC has on occasion described one of the key purposes of the consultation process preceding retrenchment as 'the protection of employment, with security of employment being a core constitutional value protected through the LRA'.[69] But, at the same time, where an employer engages in consultation in a bona fide manner, where it properly considers alternatives and where no agreement is forthcoming, the employer in principle remains free to fairly retrench employees — both substantively and procedurally.[70] And it bears repeating that procedural unfairness is limited in the sense that it cannot be the basis for reinstatement or re-employment of dismissed employees.[71]

III TRANSFER OF THE BUSINESS OR PART OF THE BUSINESS AS A GOING CONCERN

(a) The application of section 197 of the LRA

Internal attempts at restructuring described above may be the prelude to, or form part of, the use of processes involving external parties or institutions in case of financial distress. One such process, which an employer may use in conjunction with, or which may result in, retrenchment, is the transfer of the business or part of the business.

[67] *Johnson & Johnson (Pty) Ltd v Chemical Workers Industrial Union* [1998] 12 BLLR 1209 (LAC) paras 27–30.

[68] The alternatives to dismissal raised and considered during consultation will influence the substantive fairness of the dismissal. So too the selection criteria used for the retrenchment. Section 189(7) of the LRA requires either agreed selection criteria, or criteria that are fair and objective.

[69] *Secequip* para 32 with reference to *National Education Health and Allied Workers Union v University of Cape Town & others* 2003 (3) SA (1 (CC).

[70] Note that in *Buthelezi v Municipal Demarcation Board* (2005) 2 BLLR 115 (LAC) para 11 the court held that a fixed term contract terminated due to operational requirements will result in unfair dismissal. It is submitted that this case is probably incorrect. See Cohen, (LexisNexis 2015) 475.

[71] Section 193(1) read with s 193(2)*(d)* of the LRA. It should be noted that in case of a large scale retrenchment by a large employer, s 189A(13) of the LRA provides that procedural unfairness identified prior to dismissal may be used to in effect interdict the dismissal on application to the LC.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

Such a transfer may also be pursued as part of business rescue proceedings or to stave off liquidation (discussed below).

Section 197 of the LRA facilitates and regulates the transfer and security of employment of employees when an employer decides to transfer the whole or part of its company as a going concern to another company ('new employer').[72] A number of Constitutional Court decisions have been handed down on the scope and application of s 197,[73] with the most recent being *Road Traffic Management Corporation v Tasima (Pty) Ltd; Tasima (Pty) Ltd v Road Traffic Management Corporation* ('*Tasima*').[74]

In *Tasima* the court expressly dealt with the three requirements which determine the application of s 197 of the LRA to a transaction: 'business', 'transfer' and 'going concern'. It is worth recounting the court's approach in its own self-explanatory words.

In respect of the meaning of 'business' the court said:

> 'courts must examine the factual matrix of each case to establish whether an entity can be identified as a business for the purposes of section 197. A "business" is defined expansively... . "... . The aim is to cast the net as wide as possible." Courts have established what a business is by having regard to the constituent parts of the business and determining which parts are to be divested of by the transferor. A business can consist of a variety of components, including both tangible and intangible assets, goodwill, a management staff, a general workforce, premises, a name, contracts with particular clients, the activities it performs, and its operating methods. These components were explored in *Schutte*, where the Labour Court concluded that they did not constitute a closed list, but must be sufficiently connected to one another so as to form an "economic entity" that is capable of being transferred.'[75] (footnotes omitted)

In respect of the meaning of 'transfer' the court held:

> 'A transfer entails the movement of the business from one party to another and is a concept that was intended to be widely construed. A transfer under section 197 can take the form of a myriad of legal transactions, including mergers, takeovers, restructuring within companies, donations, and

[72] Section 197(1).

[73] See *Rural Maintenance (Pty) Ltd & another v Maluti-A-Phofung Local Municipality* (2017) 38 *ILJ* 295 (CC), *City Power (Pty) Ltd v Grinpal Energy Management Services (Pty) Ltd & others* (2015) 36 *ILJ* 1423 (CC), *Aviation Union of SA & another v SA Airways (Pty) Ltd & others* (2011) 32 *ILJ* 2861 (CC) and *National Education Health & Allied Workers Union v University of Cape Town & others* (2003) 24 *ILJ* 95 (CC).

[74] (2020) 41 *ILJ* 2349 (CC).

[75] *Tasima* paras 58–60. The two cases mentioned in the quotation are *Schutte & others v Powerplus Performance (Pty) Ltd & another* (1999) 2 BLLR 169 (LC) and *Harsco Metals SA (Pty) Ltd & another v ArcelorMittal SA Ltd & others* (2012) 33 *ILJ* 901 (LC).

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

exchanges of assets. In *NEHAWU*, this court held at the substance rather than the form of the transaction is relevant to the determination of whether a transfer has taken place. The mode of transfer is irrelevant, and it is of no consequence whether there is a contractual link between the transferor and the transferee. The test for determining whether there has been a transfer for the purpose of section 197 is whether the economic entity in question retained its identity after the transfer.'[76] (footnotes omitted)

And, in respect of 'going concern', the court remarked:

'Section 197 requires that a business be transferred as a ''going concern''. In *NEHAWU*, this court set out the test for determining whether a business is transferred as a going concern as follows:

> ''Whether [transfer] 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. A number of factors will be relevant to the question whether a transfer of a business as a going concern has occurred, such as the transfer or otherwise of assets both tangible and intangible, whether or not workers are taken over by the new employer, whether customers are transferred and whether or not the same business is being carried on by the new employer. What must be stressed is that this list of factors is not exhaustive and that none of them is decisive individually. They must all be considered in the overall assessment and therefore should not be considered in isolation.''

In determining whether there has been a transfer as a going concern, a primary consideration is the nature of the business. A distinction is generally drawn between labour intensive and asset-reliant services. This consideration arises because the transfer of employees alone, without the transfer of any assets, may not necessarily give rise to the transfer of a business as a going concern. Where services are involved, this court has held that what must be transferred is the business that supplies services — not the service itself. That being so, the mere termination of a service contract would not, without more, constitute a transfer within the contemplation of section 197. There must be ''other indicators'', such as whether assets and customers were transferred to the new owner and whether employees were taken over by the new owner.'[77]

[76] *Tasima* paras 85–86. The reference is to *National Education Health & Allied Workers Union v University of Cape Town & others* (2003) 24 *ILJ* 95 (CC). See also, generally, on the meaning of 'transfer' Cohen, (LexisNexis 2015) 499–508.

[77] *Tasima* paras 94–96. The reference is to *National Education Health & Allied Workers Union v University of Cape Town & others* (2003) 24 ILJ 95 (CC) para 56.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

In earlier judgments, the Constitutional Court held that there is no bar to the application of s 197 of the LRA to outsourcing arrangements or the insourcing of previously outsourced services.[78] Therefore, at first glance, with its wide scope, s 197 already provides a broad basis for the preservation of the job security of employees in case of the transfer of a business. At the same time, it has to be recognised that s 197 does not apply to all transactions. A disposal only of the assets of a business would not normally constitute a transfer as a going concern,[79] nor would a sale of shares.[80] There are also examples where companies endeavoured, sometimes successfully, to circumvent the effect of s 197 by closing down and restarting businesses. In *Maloba v Minaco Stone Germiston (Pty) Ltd & another*[81] it was held that where a company is closed down and a similar business is expanded by an associated company, this does not constitute a transfer as a going concern for purposes of s 197. In contrast, *Ponties Panel Beaters Partnership v NUMSA & others*[82] endorsed the view that closing down or interruption of a business before the new business activity commences in itself does not prevent the application of s 197. In *Welch v Kulu Motors Kenilworth (Pty) Ltd & others*[83] closure of an insolvent business followed by the transfer of most employees and assets to, and the assumption of obligations by, an associated company, was found to fall within the ambit of s 197.

(b) The consequences of the application of section 197

Once a business or part thereof is transferred as a going concern as envisaged by s 197, certain consequences arise. Section 197(2) of the LRA provides, first, that the new employer substitutes the old employer in all the contracts of employment in existence immediately before the transfer.[84] Secondly, all the rights and obligations between an employee and his/her old employer continue in the relationship with the

[78] See in this regard *Rural Maintenance; City Power; Aviation Union of SA;* and *National Education Health and Allied Workers Union* cited in footnote 73.

[79] See *Kgethe & others v LMK Manufacturing & another* [1997] 10 BLLR 1303 (LC) where it was found that an agreement to sell a portion of the assets of a business did not constitute a transfer as a going concern. This judgement was overturned on appeal in *Kgethe & others v LMK Manufacturing & another* (1998) 19 *ILJ* 524 (LAC) but on other grounds.

[80] See *Ndima & others v Waverley Blankets Ltd; Sithukuza & others v Waverly Blankets Ltd* (1999) 20 *ILJ* 1563 (LC) where the court made a distinction between a transfer of a business as a going concern and a transfer of possession and control of a business. See also *Long v Prism Holdings Ltd & another* (2012) 33 *ILJ* 1402 (LAC) and *Xaba & others v IG Tooling & Light Engineering (Pty) Ltd & others* (2019) 40 *ILJ* 638 (LC) para 33.

[81] (2000) 21 *ILJ* 1795 (LC).

[82] [2009] 2 BLLR 99 (LAC).

[83] (2013) 34 *ILJ* 1804 (LC).

[84] Section 197(2)*(a)* of the LRA.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

new employer.[85] Thirdly, all obligations of the old employer arising from the old employer's conduct prior to the transfer become obligations of the new employer (everything done by the old employer is deemed to have been done by the new employer).[86] Fourthly, continuity of employment is recognised and maintained.[87] The new employer is also in terms of s 197(5) bound by any arbitration award or collective agreements binding on the old employer. Furthermore, s 197(7) places an obligation on the old and new employer to agree, prior to the transfer, on a valuation (as at the time of transfer) of accrued leave pay, the level of entitlement to severance pay in case of retrenchment and any other accrued but unpaid payments in respect of employees who will be transferred. An agreement as to which employer will be liable for the payment of these amounts (the two employers may agree to an apportionment of liability between them) is also required, as is disclosure of this agreement to all transferred employees. The old employer must also take any other reasonable measure to ensure that the new employer makes adequate provision for its liability in respect of these payments. Should the old employer not comply with its obligations in terms of s 197, and, after the transfer, a transferred employee is retrenched or loses his/her job due to the insolvency of the new employer, s 197(8) provides that the old employer remains jointly liable, for a period of 12 months after the transfer, for any payment mentioned above. Section 197(9) provides that the old and new employers remain jointly liable in respect of claims concerning terms and conditions of employment that arose prior to the transfer.

(c) Limitations on protection of employees during transfers of businesses

The LRA expressly links protection of job security during a transfer of a business with protection against unfair dismissal. First, s 186(1)*(f)* of the LRA provides that should the new employer not adhere to its obligations to provide transferred employees with at least substantially the same conditions or circumstances at work and this leads to a termination of employment by the employee involved, this will be regarded as a dismissal (which, in turn, opens the door to an enquiry into the fairness of the dismissal). Secondly, irrespective of the form the dismissal takes and the reason for dismissal proffered by the employer (which would typically be operational requirements), where the reason for the

[85] Section 197(2)*(b)*.
[86] Section 197(2)*(c)*.
[87] Section 197(2)*(d)*.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

dismissal is a section 197 transfer, or any reason related to such a transfer, the dismissal is automatically unfair. This, however, should be seen subject to the reservations expressed in part II above about the effectiveness of protection against automatically unfair dismissal and the difficulty in challenging the (especially substantive) fairness of a retrenchment in the context of financial distress of the employer.[88] At the same time, there have been successful challenges to retrenchment in the context of transfers — especially where the dismissal was based on the new employer's operational requirements.[89] Arguably, where the dismissal for operational requirements is engaged in by the old employer as a scheme to obtain a better price for the sale of the business, there will also be room for such a challenge.[90] As Bosch states, the implication is that a dismissal immediately before the transfer for a purpose contrary to s 197 is in effect nullified. The dismissed employee may still claim against their new employer for unfair dismissal since the obligations of the old employer are transferred to the new employer.[91]

Apart from protection against dismissal, the earlier discussion showed that s 197 itself provides for further protection of employees in case of a transfer of a business. Even so, the stated consequences of a section 197 transfer are subjected to at least three limitations.[92] First, only rights that accrued at the time of transfer become part of the relationship with the new employer. Secondly, the new employer is not expected to provide employees with exactly the same terms and conditions of employment as the old employer, but to provide terms and conditions of employment that 'are on the whole not less favourable'.[93] Thirdly, and perhaps most important, where the old employer is in financial distress, s 197(6) provides that the relevant parties may contract out of almost all the consequences of s 197(2). This provision creates a lot of room for the new employer, the old employer and the employees or their trade unions to negotiate new terms and conditions

[88] In Part II above.

[89] See *Western Cape Workers Association v Halgang Properties CC* (2001) 6 BLLR 693 (LC) para 21 and *Long v Prism Holdings Ltd & another* (2012) 33 *ILJ* 1402 (LAC); Blackie & Horwitz, 'Transfer of contracts of employment as a result of mergers and acquisitions: A study of section 197 of the Labour Relations Act 66 of 1995' (1999) 20 *ILJ* 1387 at 1409; Bosch, (2002) 23 *ILJ* 641 at 644.

[90] Bosch, (2002) 23 *ILJ* 641 at 650.

[91] Bosch, (2002) 23 *ILJ* 641 at 655.

[92] For a more detailed discussion, see Garbers et al, (Mace Labour Law Publications 2019) 310ff.

[93] Section 197(3)*(a)* of the LRA.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

of employment or even to obtain agreement that certain employees will not be transferred and will be retained by the old employer or retrenched by it.[94]

(d) Transfers in case of insolvency

Where a transfer as explained above takes place in circumstances of insolvency, or where a scheme of arrangement or compromise to avoid winding-up for reasons of insolvency is entered into, the situation is changed by ss 197A and 197B of the LRA. While the meaning of 'transfer of a business' (s 197A drops the requirement of 'as a going concern') for purposes of determining the scope of application of ss 197A and B remains the same, s 197A(2)*(b)* of the LRA provides that, despite preservation of employment and continuity thereof, the rights and obligations in existence at the time of transfer remain only between the employee and the old employer. In addition, s 197(7)–(9) of the LRA do not apply to transfers in insolvent circumstances,[95] while s 197B requires disclosure of information about looming insolvency to employees.[96] These provisions arguably balance the interests of the employees with that of the new owners, who are already burdened with the task of reviving the insolvent business and ought not be further burdened with too many commitments to their new employees.[97] Interestingly, we have also seen instances of employers trying to disguise their conduct as compromises envisaged by s 197A to ensure the application of that

[94] In this regard, Garbers et al, (Mace Labour Law Publications 2019) 311 remark: 'it is not unknown for contracts that could lead to the transfer of employees in terms of section 197 to contain a clause in terms of which the coming into effect of the contracts will be subject to the condition precedent that the employees who will be transferred agree to the new employer's, less favourable, terms and conditions of employment. If the employees do not agree to the proposal made by the new employer, the contract will not come into effect. In many cases, this will have the result that the old employer will have to embark on a retrenchment exercise or perhaps even the closure of the business. In these circumstances, employees are faced with a difficult choice whether to agree to a transfer on less favourable terms and conditions of employment or to take the risk that they may be retrenched.'

[95] Section 197A(5) of the LRA.

[96] Section 197B(1) of the LRA provides 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)'. Section 197B(2) provides that '[a]n employer that applies to be wound up or sequestrated, whether in terms of the Insolvency Act, 1936, or any other law, must at the time of making application, provide a consulting party contemplated in section 189(1) with a copy of the application'. Where '[a]n employer . . . receives an application for its winding-up or sequestration [it] must supply a copy of the application to any consulting party contemplated in section 189(1), within two days of receipt, or if the proceedings are urgent, within 12 hours.'

[97] Joubert, Van Eck & Burdette, 'Impact of Labour Law on South Africa's New Corporate Rescue Mechanism' (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 70.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

section to the transaction in question and, consequently, to ensure that past liabilities associated with its new workforce are not carried into the future.[98]

As will be discussed in more detail below,[99] actual insolvency leads, first, to a suspension of contracts of employment and, thereafter, to automatic termination after the expiration of a 45-day period after appointment of the liquidator. However, the contracts of employment revive when the business is transferred.[100] The revived employment contracts will have the same content as they had at suspension or termination.[101]

(e) Interaction with competition law

The transfer of a business may at times interact with the application of principles of competition law, specifically where the transfer constitutes a merger as envisaged by s 12 of the Competition Act 89 of 1998 (the 'CA'). Employees may find additional protection in this interaction. Section 2 of the CA states that the purpose of the CA is to 'promote and maintain competition... *in order to*', inter alia, promote the economy, employment and social and economic welfare of South Africans. Employees would likely argue that a transfer of business in the form of a merger which will lead to retrenchments, fails to promote employment and, as such, is contrary to the purpose of the CA. But this argument would not necessarily succeed. The CA's primary aim is to promote competition. The listed goals are indirectly achieved by protecting the competitive process.[102] For example, the failure to promote the goal of employment cannot in itself be the reason for the merger being unsuccessful if the overall goal of competition is promoted.

However, employees are assisted by Chapter 3 of the CA, which deals with mergers. Importantly, the Competition Commission or Tribunal must assess whether the 'merger can or cannot be justified on substantial

[98] For example, in *Atlas Packaging (Pty) Ltd v Palierakis: In re Palierakis v Atlas Carton & Litho CC (in liquidation) & others* (2016) 37 *ILJ* 109 (LAC) the LAC enquired into the genuineness of the scheme of arrangement or compromise as an effort to avoid the winding-up of the old employer. Focusing on the substance and purpose of the agreement in question, the court found that it was not a true compromise or arrangement envisaged by s 197A. Rather, its purpose was, at worst, an attempt to circumvent the provisions of s 197 of the LRA and, at best, an asset-stripping exercise. This meant that the rights and obligations of the parties were not to be determined in terms of s 197A.

[99] See Part VI below.

[100] Bosch, (2002) 23 *ILJ* 641 at 654.

[101] Bosch, (2002) 23 *ILJ* 641 at 655.

[102] Sutherland & Kemp, *Competition Law of South Africa* (LexisNexis 2020) 1–59.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

public interest grounds'.[103] During the assessment, the Commission or Tribunal has to assess the impact of the merger on employment.[104] In *Metropolitan Holdings Ltd v Momentum Group Ltd*[105] the Tribunal held that a party opposing a merger merely has to show that a listed factor will be negatively affected by the merger.[106] Hence, employees opposed to the merger only have to show that their employment will be negatively affected. Proof of retrenchment as a result of the merger will suffice for this purpose.[107] The employer, as a proponent of the merger, will then have to convince the competition authorities of the benefits of the merger and the competition authorities may well approve the merger subject to conditions relating to the number and timing of retrenchments.[108] One way of doing this, is for the employer to show that the net job creation outweighs the interim job losses.[109] The ambiguity of the term 'public interest' in s 12A can therefore quite easily work in favour of employee interests. But as stated in *Minister of Economic Development & others v Competition Tribunal & others, South African Commercial, Catering and Allied Workers Union v Wal-Mart Stores Inc & another*,[110] where a merger has the potential 'to erode... employee rights', labour law and not competition law should be used to protect these rights.[111]

These provisions, along with other procedural mechanisms such as the requirement that certain intermediate and large mergers must be disclosed to the competition authorities,[112] adds another layer of protection for employees during the transfer of a financially distressed company.

IV BUSINESS RESCUE

The South African business rescue regime is regulated in Chapter 6 of the 2008 Act. The main goal of the process is to rehabilitate a financially distressed company.[113] In other words, the process aims to allow the company to continue trading on a solvent basis. This is done by placing

[103] Sections 12A(1)*(b)* and 12A(1A) of the CA.
[104] Section 12A(3)*(b)* of the CA.
[105] (2011) JOL 26835 (CT).
[106] *Momentum* paras 68–69.
[107] *Walmart Stores Inc v Massmart Holdings Ltd* (2011) 1 CPLR 145 (CT) para 51.
[108] See *Momentum* para 70 for the two-step criteria to overcome this hurdle.
[109] Sutherland & Kemp, (LexisNexis 2020) 10–127.
[110] (2012) 1 CPLR 6 (CAC).
[111] *Wal-Mart* para 136.
[112] Section 13A(1) of the CA.
[113] Section 128(1)*(b)* of the 2008 Act.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

the company under the temporary[114] supervision of the business rescue practitioner and allowing for a temporary moratorium on all claims. Should it transpire that the company cannot be rescued, the secondary goal of the process is to generate a better return for creditors than they would have received had the company been liquidated without prior business rescue efforts.[115]

A key requirement for a company to enter business rescue is that it must be financially distressed. A company is regarded as financially distressed for purposes of Chapter 6 of the 2008 Act if the company is commercially insolvent (cash-flow test) or it appears that the company will be factually insolvent within the ensuing six months (balance sheet test).[116] This differs from the initial broad approach to 'financial distress' adopted in the introduction to this article,[117] but what remains true is that the business rescue process is aimed at rehabilitating companies that are 'nearing insolvency'.[118] At the same time, it has to be recognised that a company operating on the cusp of insolvency may arguably be seen as trading recklessly, which is prohibited in terms of s 22(1) of the 2008 Act.[119] An unfortunate implication is that the business rescue process may be abused by a company to avoid liability for reckless trading, although safeguards are built in to prevent this

[114] The process is not intended to be a long-term solution. See *FirstRand Bank Limited v Normandie Restaurants Investments & another* (2016) JOL 36939 (SCA) para 20.

[115] Section 128(1)*(b)* of the 2008 Act; see also *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2013 (4) SA 539 (SCA) para 26; Cassim, (2020) 137 *SALJ* 201 at 203.

[116] Section 128(1)*(f)* of the 2008 Act; Cassim, (2020) 137 *SALJ* 201 at 208.

[117] Commercial solvency (also called 'the cash flow test') means that a company is able to pay its debts in the ordinary course of business. In contrast, factual solvency, known as the balance-sheet test, means that the company's assets exceed its liabilities. See Delport (ed), (LexisNexis 2019) 457; Cassim, (2020) 137 *SALJ* 201 at 208; *Boschpoort Ondernemings* para 21.

[118] Levenstein, *An appraisal of the new South African business rescue procedure* (unpublished LLD thesis, University of Pretoria, 2015) 142, 152, 298; Cassim, (2020) 137 *SALJ* 201 at 202.

[119] Levenstein, (2015) 298, 299; Cassim, (2020) 137 *SALJ* 201 at 204. The directors may be held liable in terms of ss 77(3)*(b)*, 218(2) of the 2008 Act. The approach for determining liability was set out in *Philotex (Pty) Ltd & others v Snyman & others* 1998 (2) SA 138 (SCA) 143F–144B, 146H–147D. The test is partially objective in that it requires the director's conduct to be that of the reasonable person. However, mere negligence (i.e. a purely objective test) is not suitable since the ordinary meaning of 'recklessness' implies something more, such as gross negligence. Consequently, the test is also partially subjective in that it measures the director's conduct against the reasonable person within the same 'sphere' and with the 'same knowledge'. The court may also have regard to external factors such as the 'powers of the directors' and 'the company's... prospects... of recovery'. Yet, the court emphasised that each case is context-specific and that a director's conduct need not amount to gross negligence for liability to follow. Accordingly, there may be cases where a court holds a director liable if their conduct falls within a spectrum between negligence and recklessness (gross negligence). See also Stevens & De Beer, 'The duty of care and skill, and reckless trading: Remedies in flux?' (2016) *SA Merc LJ* 250 at 264–268.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

from happening.[120] Nonetheless, the courts have stated that an insolvent company remains a candidate for business rescue.[121]

At face value, the business rescue process is employee-friendly.[122] Not only do contracts of employment remain in force during the business rescue process with the same terms, unless agreed otherwise,[123] but the business rescue process itself affords employees special rights and powers throughout the process.

For purposes of this section, it is useful to view the business rescue process in three phases (although there are more in practice). These phases have been chosen based on how they underline the proposition that the business rescue process is employee-friendly. It should also be noted that employees wear two different hats during the business rescue process: one as affected persons[124] and another as creditors of the company. Within the discussion of each phase below, attention will be drawn to the applicable status of employees.

The first phase deals with how and by whom the business rescue process may be initiated. The second phase involves the development and acceptance of a business rescue plan, while the last phase concerns the creditor status of the employees after commencement of the business rescue process.

(a) The initiation of the business rescue process

A financially distressed company may commence with the business rescue process[125] either voluntarily or on application to the court by an affected person, which includes employees.[126]

The board may voluntarily initiate the process by adopting a resolution to this effect, if the board has reasonable grounds to believe that the company is in financial distress (as defined in the 2008 Act) and that a

[120] See Cassim, (2020) 137 *SALJ* 201 at 202.

[121] *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technology and Engineering Company Ltd* (2013) ZAGPJHC 109 para 8.

[122] Stoop & Hutchison, 'Post-Commencement Finance – Domiciled Resident or Uneasy Foreign Transplant?' (2017) 20 *PELJ* 1 at 18.

[123] Section 136(2A)*(a)*(i) read with s 136(1)*(a)*(ii) of the 2008 Act.

[124] Section 128(1)*(a)* of the 2008 Act defines an 'affected person' as 'a shareholder or creditor of the company; any registered trade union representing employees of the company; and if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives'.
See also Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 76.

[125] See generally Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65–84.

[126] Section 129 read with s 131 of the 2008 Act.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

reasonable prospect of rescuing the company exists.[127] Thereafter the company must notify every affected person of the resolution and appoint a suitably qualified business rescue practitioner.[128] It must also notify all affected persons of the appointment of the business rescue practitioner.[129]

These notification requirements[130] enable the employees, as affected persons, to apply to court for an order that the resolution or the appointment of the practitioner be set aside.[131]

For example, employees may challenge the resolution if they are of the view that no reasonable basis exists for the belief that the company is financially distressed.[132] Such a challenge would guard against the process being abused as a sham for retrenchments. Similarly, the employees may take exception to the appointment of the practitioner if they are of the opinion that the board appointed a biased business rescue practitioner who may overlook the board's 'breaches of fiduciary duty or reckless trading'.[133] In this regard, one way in which a company may abuse the process is to resolve to initiate business rescue, but not follow through with it. Once an affected party applies to court for an order to place the company in business rescue, the company will then revive this resolution — a strategy aimed at maintaining control over the appointment of the business rescue practitioner.

If no resolution has been adopted by the company, the employees may, as affected persons, apply to court to place the company in business rescue if they are of the opinion that the company is financially distressed.[134] Employees may do so for various reasons, including that the business rescue application will suspend the liquidation proceedings, even if a final liquidation order has been granted.[135] Employees, along with other affected persons, also retain an automatic right

[127] Section 129(1) of the 2008 Act. Shareholder approval may be required in terms of the Memorandum of Incorporation since it is a more onerous provision. See Cassim, (2020) 137 *SALJ* 201 at 210.

[128] Section 129(3) of the 2008 Act.

[129] Section 129(4)*(b)*.

[130] Failure to comply with the notification requirements nullifies the resolution and prohibits the company from initiating the business rescue process for three months thereafter. See s 129(5) of the 2008 Act.

[131] Section 130(1) of the 2008 Act.

[132] Section 130(1)*(a)*.

[133] Cassim, (2020) 137 *SALJ* 201 at 202.

[134] Section 131(1) of the 2008 Act.

[135] Section 131(6) of the 2008 Act; *Richter v Absa Bank Limited* 2015 (5) SA 57 (SCA) paras 17–18.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

to participate in the proceedings if another affected person initiated the proceedings.[136]

The application will be successful if the employees, or other affected persons, are able to satisfy the court that the company is financially distressed within the meaning ascribed to this term in the 2008 Act.[137] However, the information necessary to prove financial distress may be difficult to obtain.[138] Employees are more likely to show that the company failed to pay over an employment-related amount owed to them in terms of public regulation or contract or that it is just and equitable for financial reasons to place the company in business rescue.[139] Furthermore, employees must show that there is a reasonable prospect of rescuing the company, although the court may be more flexible in deciding whether this requirement has been met, due to the difficulty employees may encounter in obtaining this information.[140]

Loubser points out that the ability of employees to place the company in business rescue is unparalleled when compared to other jurisdictions such as Germany and England.[141] In England, the administration (business rescue) process is initiated by the appointment of an administrator (practitioner).[142] The administrator may only be appointed by the company, its directors, the court on application or by the holder of a floating charge.[143] An application to court cannot be made by the employees as is the case in South Africa.[144]

In Germany, insolvency proceedings (which include both liquidation and business rescue proceedings)[145] may be initiated either by the debtor (the company) or its creditors, who must have a legal interest in the proceedings.[146] As in England, the employees also do not have the ability to initiate the proceedings.[147]

[136] Section 131(2)*(b)* read with s 131(3) of the 2008 Act; Loubser & Joubert, 'The role of trade unions and employees in South Africa's business rescue proceedings' (2015) 36(1) *ILJ* 21 at 30; *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd* 2012 (5) SA 515 (GSJ).

[137] Section 131(4)*(a)*(i) of the 2008 Act.

[138] Loubser & Joubert, (2015) 36(1) *ILJ* 21 at 30.

[139] Section 131(4)*(a)*(ii)–(iii) of the 2008 Act.

[140] Section 131(4)*(a)* of the 2008 Act; Loubser & Joubert, (2015) 36(1) *ILJ* 21 at 31.

[141] Loubser, *Some comparative aspects of corporate rescue in South African company law* (unpublished LLD thesis, University of South Africa, 2010) n 232, 53; Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 82.

[142] Loubser, (2010) 172.

[143] Loubser, (2010) 173. A creditor with a floating charge is a 'special type of company creditor' which is not recognised in South Africa. See Loubser, (2010) n 234, 196.

[144] Loubser, (2010) 174.

[145] Loubser, (2010) 249.

[146] Loubser, (2010) 251.

[147] Loubser, (2010) 255.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

Loubser argues that employees may abuse the South African process to further other grievances or as a tool in the wage negotiation process.[148] For the latter, an employer's inability to increase wages may be interpreted as financial distress for which an application for business rescue may be brought. However, it is unlikely that this would happen in practice. First, court proceedings are expensive and, secondly, employees would still have to prove financial distress and a reasonable prospect of rehabilitating the company.[149] The latter requirements serve the specific purpose of protecting the business rescue process against abuse. Nonetheless, Loubser makes the useful suggestion to introduce a statutory claim for damages against employees who abuse the process.[150]

(b) The development and acceptance of the business rescue plan

The business rescue practitioner must develop a business rescue plan in consultation with affected persons, including the employees, if a reasonable prospect of the company being rescued exists.[151] The employees, in their capacity as affected persons, will receive all the information necessary to make an informed decision,[152] including the consequences of the plan,[153] which may involve retrenchment in terms of s 189 or a s 197 of the LRA transfer.[154]

After the development and publication of the business plan, the practitioner must convene a meeting with the creditors and the holders of voting interest to discuss the proposed plan and vote on whether to accept or reject it.[155] The employees are included, now wearing the hat of creditors,[156] since they are regarded as preferred unsecured creditors at payment with regard to their remuneration and benefits due and payable before the commencement of the business rescue process.[157] Unlike in the case of insolvency proceedings (discussed below),

[148] Loubser, (2010) 54; Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 82.

[149] Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 n 117, 82.

[150] Loubser, (2010) 55.

[151] Section 140(1)*(d)*(i) read with ss 141(1), 150(1) of the 2008 Act.

[152] Section 150(2).

[153] Section 150(2)*(c)*(iii).

[154] Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 78.

[155] Section 152(1)*(d)* read with s 152(2) of the 2008 Act.

[156] Section 151(1) read with ss 145(4)*(a)*, 144(3)*(f)*.

[157] Section 144(2) of the 2008 Act. See *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd* para 21 for the complete order of preference at payment. See Stoop & Hutchison, (2017) 20 *PELJ* 1 at 18–21 for criticism.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

the 2008 Act places no limitations on the amount that may be claimed in case of business rescue, which makes the business rescue process more favourable to employees than the liquidation process.[158]

If the plan is rejected, the employees may, in their capacity as affected persons, propose the development of an alternative plan.[159]

The above means that employees not only have the right to vote on the proposed plan as a creditor, but are consulted by the practitioner as affected persons throughout the development of the plan and may even propose and assist in the development of an alternative plan.[160] As affected persons, the employees also have a bigger say in the retrenchment process compared to alternatives to the business rescue process and may vote against a plan involving retrenchment in their capacity as creditors.[161] Arguably, the aim of this phase of the process is employee-involvement to preserve jobs.[162]

The case of *South African Airways (SOC) Limited (In Business Rescue) & others v National Union of Metalworkers of South Africa obo Members & others* ('*SAA*')[163] illustrates the important link between the business rescue plan and retrenchment to the benefit of employees. South African Airways ('SAA') commenced with voluntary business rescue in December 2019.[164] During March 2020, the business rescue practitioners of SAA issued a consultation notice in terms of ss 189 and 189A of the LRA for large-scale retrenchments.[165] This notice preceded the business rescue plan, which was only published in July 2020.[166] The LC held that a purposive interpretation of s 136(1)*(b)* of the 2008 Act meant that retrenchment may only follow once the business rescue plan has been finalised and approved.[167] As such, the notice 'was premature and amounted to procedural unfairness'.[168]

The LAC confirmed the LC's judgment. It drew attention to the phrase 'retrenchment... *contemplated in* the company's business rescue plan' (own emphasis) in s 136(1)*(b)* and held that a proper reading

[158] Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 80.
[159] Section 144(3)*(g)*(i) read with s 153(1)*(b)*(i)*(aa)* of the 2008 Act.
[160] Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 79.
[161] Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 81.
[162] Levenstein, (2015) 458.
[163] (2020) 8 BLLR 756 (LAC).
[164] *SAA* para 3.
[165] *SAA* para 7.
[166] *SAA* paras 9–10.
[167] *SAA* para 11.
[168] *SAA* para 12.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

thereof meant that retrenchment in the context of business rescue proceedings is founded in the rescue plan.[169] Furthermore, it noted that the overall purpose of the South African business rescue regime ought to be considered. One of the main purposes of the regime is to preserve jobs.[170] Allowing retrenchments to precede the business rescue plan would negatively affect this purpose.[171]

It is submitted that this approach is correct. To hold that retrenchments may precede the business rescue plan would allow business rescue practitioners to circumvent employee-involvement in the business rescue process and would be contrary to the purpose of Chapter 6 of the 2008 Act, which is aimed at employee protection through the implementation of business rescue as an alternative to winding-up.

However, employee-involvement as a means of employee protection may at times have the opposite effect. Critics have pointed out that employees are able to disrupt the process by being obstructive or too demanding during the development of the plan or by rejecting the plan as voters.[172] This can make the business rescue process time-consuming and may ultimately lead to the failure of the business rescue proceedings.[173] As Joubert et al mention, the subsequent liquidation of the business as a result of this failure would be more detrimental to the employees and the economy.[174] Employees should heed the warning that unnecessary disruption could ultimately be their downfall.

(c) Post-commencement of the business rescue process

Section 135 of the 2008 Act provides for the financing of the business rescue process, known as post-commencement financing. The purpose of the provision is to allow the company to continue trading while the business rescue process is underway.[175] The lender (or financier) may become a secured creditor, which gives them preference at payment over the other creditors.[176] However, any employment-related expenses

[169] *SAA* para 31.
[170] *SAA* para 29.
[171] *SAA* para 33.
[172] Levenstein states that it may exacerbate an already delicate relationship between employers and employees. See Levenstein, (2015) 458.
[173] Levenstein, (2015) 458.
[174] Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 83–84.
[175] *South African Property Owners Association v Minister of Trade and Industry & others* 2018 (2) SA 523 (GP) para 22.
[176] Section 135(2) of the 2008 Act. Post commencement financiers arguably do not have the right to vote on the business rescue plan, unlike the other creditors. See Cassim, (2020) 137 *SALJ* 201 at 213.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

which become due and payable *during* the business rescue process will also be regarded as post-commencement financing.[177] The effect is that employee claims arising during the post-commencement phase supersede all other claims, including that of the secured lender as well as the unsecured employee claims that arose before the commencement of the business rescue process.[178] The only claims that will not be superseded by the post-commencement claims of the employee are the costs associated with the business rescue process, such as the costs of the business rescue practitioner.[179] This hierarchy continues even if the business rescue proceedings are converted to liquidation proceedings.[180] As noted, this hierarchy detracts from the incentive lenders may have to invest in business rescue, since their claims have a lower ranking than the post-commencement claims of the employees when it comes to payment.[181]

This elevation of employees to 'super creditors' could be viewed as an infringement of the section 25 constitutional property rights of secured post-commencement financiers.[182] Other creditors may also challenge the hierarchy of type and payment of creditors on the basis that there is no rationality for the differential treatment.[183] It is unlikely that creditors would succeed with this argument, since the right to equality, dignity and fair labour practices of employees as well as the limitations clause may well prevail in the eyes of the court.[184]

V WINDING UP OF A COMPANY IN FINANCIAL DISTRESS

Unlike the business rescue process, employees as creditors of a company have limited protection in the event that the company is wound up. As will be discussed, employees are procedurally protected by notification requirements that allow them the opportunity to suggest alternatives to the winding up of the company. Furthermore, employees are substantively and procedurally protected by the Insolvency Act 24 of 1936 (the 'IA') which makes provision for consultation procedures

[177] Section 135(1)*(a)* of the 2008 Act.
[178] Section 135(3)(*a*).
[179] Section 135(3).
[180] Section 135(4).
[181] Joubert et al, (2011) 27 *International Journal of Comparative Labour Law and Industrial Relations* 65 at 80.
[182] Van Eck et al, (2004) 121 *SALJ* 902 at 918. See also s 25 of the Constitution of the Republic of South Africa, 1996 (the Constitution).
[183] Section 9 of the Constitution; Van Eck et al, (2004) 121 *SALJ* 902 at 918.
[184] Sections 9, 10, 23, 36 of the Constitution; *Sidumo* para 74.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

and lists employees as preferent creditors. However, as will be shown, the protection is insubstantial and requires re-evaluation.

(a) The process of winding up the company

Item 9 of Schedule 5 of the 2008 Act provides that the winding-up provisions of the 1973 Act continue to apply to insolvent companies and are deemed to not have been repealed.

In terms of the 1973 Act, an insolvent company may be wound up in one of two ways.[185] A company may voluntarily liquidate itself by adopting a special resolution,[186] after which the process is steered by either the members or creditors of the company, depending on the resolution.[187] Alternatively, a company may be wound up by the court after an application has been made by the company[188] or a party listed in s 346(1) of the 1973 Act. Section 344 sets out the circumstances in which the court may grant an order for the winding up of an insolvent company. The use of the word 'may' indicates that the court has a discretion to wind up the company. This discretion would also allow the court to order business rescue, depending on the arguments advanced by the parties and subject to the initiation requirements as stipulated above.

One of the circumstances where the company may be wound up by the court is if it is unable to pay its debts as described in s 345.[189] After the winding-up process is completed, the company will be dissolved, the effect being deregistration.[190] Deregistration of the company means that the employees will no longer be able to enforce any claims against the company.[191]

[185] Section 343(1) of the 1973 Act.

[186] Section 349.

[187] Section 343(2). See *Murray & others NNO v African Global Holdings (Pty) Ltd & others* 2020 (2) SA 93 (SCA) para 23 in which the court held that voluntary liquidation is still available to insolvent companies.

[188] The 'company' refers to the board, who has the power in terms of s 66(1) of the 2008 Act to manage the affairs of the company. See obiter dictum in *Ex Parte New Seasons Auto Holdings (Pty) Ltd* 2008 (4) SA 341 (W) 345B-E.

[189] Section 344*(f)* of the 1973 Act.

[190] Section 419 of the 1973 Act read with ss 82–83 of the 2008 Act; *Bowman NO v Sacks & others* 1986 (4) SA 459 (W) 463F. Dissolution and deregistration have amalgamated in terms of the 2008 Act. See *ABSA Bank Ltd v Companies & Intellectual Prop Commission & others* (2013) 3 All SA 34 (WCC) para 37.

[191] *Bowman NO v Sacks & others* 1986 (4) SA 459 (W) 464B.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

(b) Substantive and procedural protection of employees in the liquidation process

(i) Notification

In terms of s 346(4A) of the 1973 Act, if an application is made for the winding up of the insolvent company, the applicant must notify both the registered trade union representing employees and the employees of the company of the application. This notification is a peremptory requirement, and the court cannot condone non-compliance, although it does have some flexibility as to what constitutes compliance in the context.[192] This provides procedural relief to the employees of the company, who may oppose the application for winding up on the basis of non-compliance with the notification requirement.

These provisions are echoed in s 197B(2) of the LRA, which requires an employer who receives an application for winding up, or applies to be wound up, to provide its employees, their trade unions or representatives with a copy of the application. This does not apply where a company is voluntarily liquidated.[193] Furthermore, s 197B(1) of the LRA requires a financially distressed employer who foresees the likelihood of liquidation to consult the above-mentioned parties. The purpose of this provision is to draw the attention of the employees to the winding up of the company or the possibility thereof, which ultimately enables them to reasonably protect their interests.[194]

Overall, as stated in *Stratford & others v Investec Bank Limited & others*,[195] the various notification provisions allow employees to make 'alternative arrangements' and 'signifies respect for the human dignity of employees'.[196]

(ii) Insolvency law

The law of insolvency applies mutatis mutandis to the winding up of an insolvent company.[197] Prior to the 2003 amendment of the IA, contracts of employment automatically terminated upon (provisional) liquidation.[198] Since the 2003 amendment, the protection afforded to employees in the insolvency regime has increased significantly.

[192] *EB Steam Company (Pty) Ltd v Eskom Holdings Soc Ltd* (2014) 1 All SA 294 (SCA) para 18.
[193] Van Eck et al, (2004) 121 *SALJ* 902 at 924.
[194] *EB Steam Company (Pty) Ltd v Eskom Holdings Soc Ltd* (2014) 1 All SA 294 (SCA) para 7.
[195] 2015 (3) SA 1 (CC).
[196] *Stratford* para 34.
[197] Section 339 of the 1973 Act.
[198] Van Eck et al, (2004) 121 *SALJ* 902 at 908.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

Section 339 of the 1973 Act read with s 38(1) of the IA now provides that an employee's contract of employment is suspended from the date the employer's sequestration order is granted. If applied to the liquidation of an insolvent company, employment contracts of employees of the company will also be suspended once the liquidation order for the insolvent company is obtained.[199] During this suspension, the employee will not be required to render services, nor will the employee be entitled to remuneration or employment benefits connected to the suspended contract, which accrues during this time.[200] The employee will still be entitled to unemployment benefits.[201] This differs from the business rescue process, where the employee will continue to be employed on the same terms and conditions.[202]

Section 38 also provides specifically for the liquidator to terminate any contract of employment during the suspension period for reasons pertaining to the company's insolvency, subject to consulting the relevant workplace forum, trade union, employee or employee representative.[203] The liquidator need not comply with s 189 of the LRA.[204] However, the consultation process in terms of s 38(5) of the IA is very similar to that of s 189 of the LRA.[205] The aim of the process is to explore alternatives to the winding up of the company, such as the transfer or business rescue thereof.[206]

In addition, the liquidator may only terminate the contracts of employment after considering any proposal made by any of the employees or their representatives.[207] If no agreement about continued employment is concluded between the liquidator and the relevant parties, the contracts of employment automatically terminate 45 days after the date of appointment of the liquidator.[208] Interestingly, a suspended employee remains an affected person for purposes of the business rescue process until their contract of employment automatically terminates after the 45-day period.[209] As such, employees whose

[199] Section 339 of the 1973 Act read with s 38(1) of the IA.
[200] Section 38(2) of the IA.
[201] Section 38(3).
[202] Section 136(1)*(a)* read with s 136(2A) of the 2008 Act; *FirstRand Bank Ltd v KJ Foods CC (In business rescue)* 2017 (5) SA 40 (SCA) para 38.
[203] Section 38(4)–(5) of the IA; Van Eck et al, (2004) 121 *SALJ* 902 at 910.
[204] Boraine, Kunst & Burdette (eds), *Meskin's Insolvency Law* (LexisNexis 2020) 5.21.10.2.
[205] Van Eck et al, (2004) 121 *SALJ* 902 at 910.
[206] Section 38(6) of the IA.
[207] Section 38(7).
[208] Section 38(9).
[209] See *Richter v Bloempro CC & others* 2014 (6) SA 38 (GP); Loubser & Joubert, (2015) 36(1) *ILJ* 21 at 29.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

contracts of employment have been suspended still have locus standi to apply for business rescue during this period.[210]

An employee whose contract has been suspended or terminated by the liquidator or whose contract automatically terminates may claim compensation for loss suffered as a result of the suspension or termination of the contract.[211]

Van Eck et al argue that the consequences of failing to comply with the IA-termination procedures are similar to the consequences for unfair dismissal based on operational requirements. First, an employee may approach the High Court or LC to require the liquidator to comply with the consultation procedure. If the liquidator then fails to comply with the procedure, the employee may approach the LC on the basis of an alleged unfair dismissal for operational requirements. The employee may then be entitled to relief in terms of the LRA, namely reinstatement, re-employment or compensation.[212] Practically neither reinstatement nor re-employment would be appropriate and since employees are not entitled to remuneration during the suspension period, compensation is also unlikely.[213] It seems that the only protection available is to challenge the validity of the consultation process.

A further advantage enjoyed by employees in terms of the IA is that they are regarded as statutory preferential creditors. This means that the employees of the company are entitled to the free residue of the company's estate immediately after the liquidation costs have been settled.[214] The free residue constitutes:

> 'the portion of the estate which is not subject to any security, as well as any balance remaining after settling a secured claim out of the proceeds of the sale of the particular asset which secured the payment of the debt'.[215]

An employee may claim their salary in arrears, unpaid benefits and severance pay from the free residue, subject to certain limitations.[216] The purpose of this provision is to lessen the impact of liquidation on employees, but without hindering the main objective of fair distribution of the free residue.[217] However, there are some limitations to this protection. Employee claims may exceed the maximum amount

[210] Loubser & Joubert, (2015) 36(1) *ILJ* 21 at 29.
[211] Section 38(10) of the IA.
[212] Van Eck et al, (2004) 121 *SALJ* 902 at 913.
[213] Van Eck et al, (2004) 121 *SALJ* 902 at 914.
[214] Section 97 of the IA.
[215] Van Eck et al, (2004) 121 *SALJ* 902 at 917.
[216] Van Eck et al, (2004) 121 *SALJ* 902 at 917. See s 98A of the IA for limitations.
[217] *Commissioner for the South African Revenue Service v Pieters & others* 2020 (1) SA 22 (SCA) para 11.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

prescribed by the Minister, in which case they become concurrent unsecured creditors for the remaining portion of their claim.[218] Furthermore, if the free residue is insufficient to cover the liquidation costs, the employees, together with the other creditors, must foot the bill.[219] This may cause financial strain for the employees.[220]

Although the liquidation process in its current state protects the employees of a company to some degree, the final result may nevertheless be unemployment.[221] In order to preserve their jobs, employees would probably prefer the other avenues of recovery considered above. Alternatives to liquidation suggested by the employees will likely be a mix of internal restructuring, transfer of (parts of) the business or business rescue.

VI CONCLUSION

This article sought to juxtapose the legislative regulation of four, often interrelated, processes that may result from the financial distress of a company and to review the impact of these processes on the job security of the company's employees. While job security was accepted to mean both preservation of employment as well as preservation of terms and conditions of employment, the argument was made that, in effect, job security in the context of financial distress of the employer boils down to preservation of employment and protection against dismissal.

As far as voluntary internal restructuring is concerned, several insights presented themselves. In case of financial distress, the question about the protection of employees where an employer embarks on restructuring, ultimately is a question about the efficacy of protection against unfair dismissal in the LRA. This protection, for the reasons discussed, is largely procedural. The use of s 187 (protection against automatically unfair dismissal) and s 189 of the LRA to challenge the substantive fairness (the reason) of a dismissal for operational reasons is already difficult in light of the approach of the courts to the application of these sections, more so in case of the employer's financial distress. Furthermore, even where procedural unfairness is found to exist, it will

[218] Section 98A(2)*(a)* read with s 103 of the IA.
[219] Section 106.
[220] Van Eck et al, (2004) 121 *SALJ* 902 at 919.
[221] It has been argued that South African insolvency law has stagnated in the last decade, resulting in economic inefficiencies and limited protection for employees and, in light of the Covid-19 pandemic, that urgent insolvency reform is necessary to mitigate the economic impact of the pandemic. See Calitz, 'Insolvency law adjustment in response to the economic impact of the Covid-19 pandemic: the South African experience' 2020(4) *TSAR* 763–776.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

at best lead to a delay in the dismissal[222] or a post-dismissal award of compensation,[223] not the retrospective preservation of employment.

The second process, which is a possible transfer of the business or part of the business, is regulated by ss 197 and 197A in such a way that the job security of employee's post-transfer seems secure, both as far as preservation of employment and of terms and conditions of employment are concerned. While the courts have emphasised the wide reach of s 197, the discussion also identified instances where these sections do not apply, such as where employers have successfully circumvented their reach and instances where the actual protection of these sections is limited. Notable in this regard is the freedom of employers to negotiate pre-transfer about worse terms and conditions of employment post-transfer against the background of a looming retrenchment which will be difficult to challenge on a substantive basis. The discussion also showed that protection of employees during transfers might well come from an unexpected source, namely the Competition Commission, at least in those instances where the transfer falls under the merger provisions of the CA.

From the discussion it seems clear that the third process, which is business rescue, offers the most security to employees, given their status as affected persons and creditors of the company for purposes of the process. The business rescue process already provides employees with the opportunity to initiate or influence the decision to embark on business rescue, with preservation of employment, with employee input in development of the business rescue plan and, as recently decided by the LAC, with prevention of retrenchment until after adoption of that plan. At the same time, a company in business rescue might be hamstrung by the numerous safeguards for employees built into the process from the inception of business rescue. For example, employees must be consulted throughout the development of the business rescue plan, may propose alternative plans, and may vote on the final plan as creditors. They also enjoy a higher ranking for all their claims than almost all of the creditors of the company. As such, from the perspective of employees, one could very well say that business rescue is employment rescue. However, it is exactly the strength of this protection of employees that may prove to be the main weakness of business rescue.

[222] In case of a large-scale retrenchment by a large employer through the operation of s 189A(13) of the LRA. This section provides that procedural unfairness identified prior to dismissal may be used to in effect interdict the dismissal on application to the LC.

[223] In case of a retrenchment other than a large-scale retrenchment by a large employer. See s 193(1)–(2) of the LRA.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd

The business rescue process may be time-consuming, may deter post-commencement financing and may result in failure and subsequent liquidation.

The last process, which is winding up, is the most invasive of the processes considered in the sense that it results in dissolution and deregistration of the company and permanent job losses. Even so, the procedural protection for employees in the run-up to liquidation is built around notification of the impending process, participation in the process, the temporary suspension of employment contracts (as opposed to immediate termination of employment) and consultation with employees prior to any termination of employment. Furthermore, the process is flexible enough to incorporate a transfer of the business (or part of the business), which may well ensure future employment, or reversion to business rescue proceedings with its relatively beneficial effect on employees.

Ultimately, however, and whatever process is engaged in and whatever procedural safeguards exist, the protection of employees in times of financial distress largely comes down to effective protection against dismissal based on operational reasons. As was argued in this paper, the effect of s 187 of the LRA in the case of financial distress is limited and it remains difficult to challenge the substantive fairness of dismissal for operational requirements to ensure continued employment. However, while it may be difficult for employees to successfully challenge the decision underlying their loss of employment as a result of the financial difficulties the employer experiences, legislation arguably provides for adequate and justifiable involvement in the processes and decision-making prior to these job losses.

https://doi.org/10.47348/SAMLJ/v33/i2a3

© Juta and Company (Pty) Ltd