

ALUTA CONTINUA, OR CLOSING THE GENERATION GAP: SECTION 197 OF THE LRA AND ITS APPLICATION TO OUTSOURCING*

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SUMMARY

There has recently been a fair amount of debate around whether section 197 of the Labour Relations Act applies to so-called 'second generation' business transfers. The Labour Court has held that it can, provided the relevant business is transferred as a going concern. This article analyses and considers the correctness and desirability of that decision in light of the relevant statutory provisions, the proper approach to interpreting the provisions of the LRA, the practical consequences of the decision, the criticism that has been levelled at the decision and comparative law.

1 INTRODUCTION

Section 197 of the Labour Relations Act 66 of 1995 (hereinafter "the LRA") has long been a source of confusion and concern. As Benjamin has noted, there is perhaps no other section of the Act that has "given rise to such widely divergent interpretations".¹ That is unfortunate given the fundamental importance of the section in the context of business restructuring. Despite amendments to section 197 in 2002 subsequent court decisions have demonstrated that the applicability of the section remains contested terrain.²

* This article is based on a paper presented at the 19th Annual Labour Law Conference held in Sandton, South Africa in July 2006.

¹ Benjamin "A Matter of Ongoing Concern: Judicial Interpretation and Misinterpretation of Section 197 of the Labour Relations Act" 2005 (2) *Law, Democracy & Development* 169.

² A case in point is the decision of the Labour Appeal Court in *SAMWU v Rand Airport Management Company* 2005 26 *ILJ* 67 (LAC) where, in deciding whether gardening services were a "service" for the purposes of s 197(1)(a), the court focused almost entirely on the function performed by the relevant entity. It is suggested that it is problematic to determine that an entity is a "business" for the purposes of s 197 with reference to only one of its features. That approach is not in line with the wealth of European jurisprudence so

Many of the cases shaping the scope of section 197 have related to cases involving so-called outsourcing. The current controversy relates to whether the section can apply to so-called “second generation contracting-out”. This term refers to a situation where an employer has outsourced a function to a service provider and the contract between those parties comes to an end. The employer then concludes an agreement for the provision of the relevant services with a new contractor. The terms “second generation contracting-out” and “outsourcing” are not terms of art and it is not important to determine whether a particular transaction qualifies as one or the other to bring it within section 197.³ In every case it must be determined whether there has been a transfer of a business from one employer to another as a going concern. Having said that, the term second generation contracting-out will be used in this article for the sake of convenience.

The decision of the Labour Court in *COSAWU v Zikhethele Trade (Pty) Ltd*⁴ recently brought the question of the application of section 197 to second generation contracting-out starkly to the fore. This was an important judgment in that it related to what is an increasingly prevalent form of business restructuring and touches on fundamental issues relating to the proper interpretation of the LRA. The decision has also been widely criticised.⁵ The aim of this article is to examine the extent to which s197 applies in the context of second generation contracting-out. The decision in the *Zikhethele* case will be used as a starting point to explore whether the criticism levelled at it is justified. Issues other than those arising in *Zikhethele* that are relevant to the application of section 197 to second generation contracting-out and similar transactions will also be considered.

often cited by the courts when interpreting s 197. Nor does it seem to fit with the multifactorial test for transfer as a going concern laid down by the Constitutional Court in *NEHAWU v University of Cape Town* 2003 24 ILJ 95 (CC) 119-120. See also Van Niekerk “Bleached Skeletons Resurrected and Vibrant Horses Corralled – SA Municipal Workers Union v Rand Airport Management Company (Pty) Ltd & others and the Outsourcing of Services” 2005 26 ILJ 661; and Du Toit “Labour Law and Productive Decentralisation: What Future for Outsourcing? A South African Perspective” unpublished paper presented at the XVIII World Congress of the International Society for Labour and Social Security Law, Paris, September 2006.

³ Wallis “Is Outsourcing In? An Ongoing Concern” 2006 27 ILJ 1 4 points out that: “Neither in conception nor in principle are any of these [s 197, the European Acquired Rights Directive and the UK’s Transfer of Undertakings (Protection of Employment) Regulations] statutory measures directed at outsourcing or contracting-out. Instead their focus is different. Measures such as these have their genesis in very simple factual situations where the business, rather than the legal entity that owns the business, changes hands.” His objection to the courts pigeonholing of transfers as being of a particular type and thus necessarily bearing certain consequences when it comes to the application of s 197 is well-founded.

⁴ 2005 26 ILJ 1056 (LC).

⁵ See Wallis 2006 27 ILJ 1; Le Roux “Outsourcing and the Transfer of Employees to Another Employer: What Happens in the ‘Second Generation’ Transfer” 2005 14(12) *Contemporary Labour Law* 111; Grogan “Second Generation Outsourcing: The Reach of Section 197” 2005 21(5) *Employment Law* 10; and De Kok SASLAW Case Law Update, presented to the Gauteng chapter of SASLAW on 21 November 2005.

2 THE DECISION IN *COSAWU V ZIKHETHELE TRADE (PTY) LTD*

The facts of the case were as follows: Fresh Produce Terminal (FPT) contracted with Khulisa Terminal Services (Khulisa) to provide terminal and stevedoring services at harbours in Cape Town, Port Elizabeth and Durban. Infighting within Khulisa caused FPT to terminate its contract with the company. FPT then invited the factions within Khulisa to apply for the contract. This led to the formation of the respondent, Zikhethale Trade. Zikhethale was awarded the contract but the unsuccessful applicant initiated proceedings in the High Court seeking to interdict the implementation of the contract.

Zikhethale told the employees of Khulisa that they would be “seconded” to Zikhethale pending the outcome of the proceedings in the High Court. They would remain the employees of Khulisa but were invited to apply for positions with Zikhethale. All of Khulisa’s employees in Port Elizabeth and Durban were transferred to Zikhethale, but the employees in Cape Town were informed that Zikhethale would decide which of those who had applied and been interviewed it was going to employ. The union responded by advising Zikhethale that its members had applied for positions without prejudice to their rights and that the union considered such applications unnecessary because its members’ contracts had transferred to Zikhethale automatically by virtue of section 197 of the LRA. Zikhethale eventually employed 104 of the 147 Cape Town employees. Zikhethale and Khulisa had the same managing director, Zikhethale operated from the same premises as Khulisa in Cape Town, Durban and Port Elizabeth. Zikhethale used the same telephone number, fittings and other equipment used by Khulisa and its main client and largest asset was, as with Khulisa, FPT.

Prior to the decision in *Zikhethale* it had been argued that section 197 could not apply to second generation contracting-out because the section speaks of a transfer of a business “by” the old employer.⁶ The argument was that in the second generation scenario the transfer is by the client to whom the service is being rendered and not the old employer, that is, the outgoing contractor. Murphy AJ acknowledged that:

“[A] compelling argument can be made, based on the express language in section 197 of the LRA, that the requirement in section 197(1)(b) that a transfer of business be *by* one employer to another precludes its application to second generation contracting-out, because in such arrangements nothing is transferred by the old employer to the new employer”.

Thus, in this case it could have been argued that section 197 did not apply because the business transferred to Zikhethale as a going concern was not transferred by the efforts of Khulisa, but by FPT who had never employed

⁶ See Grogan “Outsourcing Workers: A Fresh Look at Section 197” 2000 *Employment Law* 15 18; and Wallis “Section 197 is the Medium. What is the Message?” 2000 21 *ILJ* 1 4. S 197(1)(b) provides that “‘transfer’ means the transfer of a business *by* one employer (‘the old employer’) to another employer (‘the new employer’) as a going concern” (my own emphasis added).

the employees in question. But the judge did not endorse this view. Rather, he found that s197 can apply to second generation contracting-out. This was because our courts do not require that there be a contractual link between the old and the new employers in order for s197 to apply to a transfer.⁷ Secondly, in the court's view, a purposive approach to interpreting s197 indicated that:

"S 197(1)(b) might be better interpreted to apply to transfers 'from' one employer to another, as opposed to only those effected 'by' the old employer. A pragmatic interpretation of this kind allows a finding that a business in actual fact can be transferred by the old employer in such circumstances, but that the transfer occurs in two phases: in the first, the business is handed back to the outsourcer; and in the second, it is awarded to the new employer".⁸

This (purposive) interpretation of the provision was required in light of the court's obligation to interpret and apply the LRA in accordance with the Constitution⁹ and was also suggested by relevant foreign jurisprudence. The court noted that:

"[A] mechanical application of the literal meaning of the word 'by' in s 197(1)(b) would lead to the anomaly that workers transferred as part of first generation contracting-out would be protected whereas those in a second generation scheme would not when both are equally deserving of protection".

In the court's view a more "pragmatic" interpretation of section 197(1)(b) allowed it to find that the transfer occurred in two phases. In the first phase the business was handed back to the outsourcer/client. In the second phase it was awarded to the incoming contractor. Applying its analysis of section 197 to the facts before it the court found that the business of Khulisa had transferred to Zikhethele as a going concern, given that it had retained its identity to a sufficient degree.

3 ANALYSIS

3.1 The two-stage transfer

The decision in *Zikhethele* is to be welcomed for its clear attempt to give effect to the constitutional right to fair labour practice, to the purpose of the LRA in general and that of section 197 in particular. That is not to say that the judgment does not give rise to certain difficulties. It has been suggested that it was not necessary for the court to find that the transfer occurred in two phases because a number of the components of the relevant business were

⁷ *COSAWU v Zikhethele Trade (Pty) Ltd supra* 1066; and see *Nokeng Tsa Taemane Local Municipality v Metsweding District Municipality* 2003 24 ILJ 2179 (LC).

⁸ *COSAWU v Zikhethele Trade (Pty) Ltd supra* 1066.

⁹ S 1 of the LRA stipulates that one of the primary objects of the Act is to give effect to the fundamental rights contained in s 23 of the Constitution whereas s 3 requires anyone interpreting the LRA to do so in a manner that gives effect to its primary objects and in compliance with the Constitution. S 39(2) of the Constitution provides that "when interpreting any legislation ... every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights".

actually transferred “by” Khulisa directly to Zikhethela.¹⁰ That criticism is justified, but only if those components were actually transferred by Khulisa to Zikhethela (in the sense of Khulisa being active in their transfer), and it is not entirely clear how many of them were. Thus, it is not apparent whether the premises, fittings and equipment used by Zikhethela were provided by Khulisa or by the client, FPT. The opportunity to do the work for FPT was transferred by FPT. The suppliers of Zikhethela also supplied Khulisa, but they were not transferred by Khulisa. And, although the employees were seconded to Zikhethela by Khulisa, it was Khulisa’s intention to dismiss its employees who would then be re-employed if Zikhethela wanted them. While the facts of the case, as they appeared from the judgment, do not necessarily support the above-mentioned criticism of the *Zikhethela* decision, those levelling the criticism appear to accept that second generation contracting-out is not entirely excluded from the reach of section 197 even on its present wording.¹¹

With the benefit of hindsight, a more cogent criticism of the two-stage approach adopted in *Zikhethela* is that it was unnecessary to find that the transfer occurred in two phases because of the interpretation of section 197 adopted by the court. If one accepts that section 197 applies to transfers “from” one employer to another, *how* the transfer occurred is insignificant. All that is important is that the entity that is transferred is a “business” and that it is transferred from the old to the new employer as a going concern. In addition, logically and practically, one cannot speak of the business as if it was in the hands of Khulisa transferring to Zikhethela via the client FPT. The client did not take possession of, and transfer to Zikhethela, much more than the opportunity to provide the relevant services.¹²

3.2 The contents of section 197

At the level of principle, it has been argued that it is perfectly plausible and acceptable that the legislature intended that section 197 should not apply to second generation contracting-out. According to Wallis:

“[I]t is a perfectly reasonable hypothesis that the legislature deliberately decided to limit the scope of the section to those transactions where two parties decide to bring about a change in ownership of a business (as defined) by whatever means, but not to extend the section to more remote situations as has occurred elsewhere”.¹³

He goes on to point out that if the legislature had wanted to amend section 197 to incorporate transactions like second generation contracting-

¹⁰ Le Roux 2005 14(12) *Contemporary Labour Law* 111 115; and Grogan 2005 21(5) *Employment Law* 13-14.

¹¹ See also Wallis 2006 27 *ILJ* 14.

¹² De Kok (SASLAW Case Law Update, presented to the Gauteng chapter of SASLAW on 21 November 2005) points out that if a contract is validly terminated it ceases to exist and cannot therefore be transferred. It is thus better to speak of the *work*, or opportunity to work being transferred from the outgoing to the incoming contractor. See also Benjamin 2005 (2) *Law, Democracy & Development* 169 177.

¹³ Wallis 2006 27 *ILJ* 13.

out it would have done so in 2002 when section 197 underwent extensive amendments after a great deal of debate between the parties at the National Economic Development and Labour Council (NEDLAC) and elsewhere. However, there is no indication that the debates prior to the introduction of the 2002 amendments dealt with the application of section 197 to second generation contracting-out. One can therefore just as well assume that the legislature did not apply its mind to the matter, as assume that it did. It is also worth bearing in mind that due to its effectively being a “national collective agreement”¹⁴ the LRA is the product of attempts to accommodate the social partners and the formulations they prefer. It reflects the compromises and trade-offs of the negotiation process. That may have been what led to the kind of unintended consequences that resulted in a need for amendments in 2002 and may necessitate further amendment in future.

Wallis argues that the amended section 197 creates the impression that the legislature did not intend that the section to apply to second generation contracting-out, where the outgoing and incoming contractors are not in a direct contractual relationship. This is because the outgoing contractor would be reluctant to enter into a section 197(7) agreement with the new contractor who would be its direct competition, particularly in circumstances where the old contractor had just lost the contract. And section 197(8) is not sufficient compulsion to ensure that the “transferor” will comply with its section 197(7) obligations, given that retrenched workers will always look to the new, rather than the old, employer for severance pay. However, if the employers were in a direct relationship “compliance would be straightforward as with any other administrative requirement”.¹⁵

It is, however, trite that the fact that legislation is going to cause difficulty and reluctant compliance has never prevented the legislature from passing such legislation. Legislation is often introduced to compel parties to do what they would otherwise choose not to do. The conclusion of a section 197(7) agreement is compulsory for the outgoing contractor. The fact that requiring it from that contractor might be awkward or meet with resistance cannot be taken as a sign that the legislature did not intend it. In fact, the existence of a penalty for non-compliance with section 197(7) might be taken to indicate that the legislature envisaged that it would have to be complied with in circumstances where the old employer would be resistant or reluctant. In addition, section 197(8) is perhaps not all that toothless. If it is not complied with the affected employees may look to either the old or the new employer for the full amount of their severance pay. That is the case for 12 months after the section 197 transfer and the non-compliant old employer thus faces the prospect of liability for an additional year’s severance pay if it does not meet its obligations under section 197(8). It has also been suggested that

¹⁴ Van Niekerk “The New Amendments – Who Wins? The Original vs the Current Amendments (LRA)” paper presented at the 15th Annual Labour Law Conference July 2002 Sandton.

¹⁵ Wallis 2006 27 *ILJ* 13.

compliance by the old employer with the duties set out in section 197(7) may be compelled by the Labour Court.¹⁶

3 3 Practical problems

Various commentators have pointed to the practical difficulties that would arise if section 197 were applied to second generation contracting-out. For example, it has been suggested that a person tendering for a contract will find it difficult to determine the appropriate amount to quote for providing its services. That is because, if section 197 applies to second generation contracting-out, the incoming contractor will have to take on the employees of the incumbent contractor on their existing terms and conditions. Information as to what those are will not be generally available and it is unlikely that the incumbent contractor, who may be competing for the contract, will be happy to inform its competitors what remuneration and benefits its employees receive. In addition, the tendering contractor will have no idea what kinds of liabilities it might be inheriting with respect to employees' years of service, claims for unfair dismissal or unfair discrimination, *etcetera*. Nor will that person have the opportunity to obtain the necessary information through due diligence exercises on the existing contractor, nor would it be in a position to claim any indemnities from the existing contractor.¹⁷

It has also been argued that the tendering contractor would have difficulty entering into an agreement in terms of section 197(6) in order to vary the consequences of section 197. That is because the tendering contractor would probably not have access to the relevant employee representatives before the transfer, and after transfer it would be more difficult to agree to change as the transferred employees would have greater negotiating power. Finally, it is conceivable that, if the costs of taking over the existing contractor's employees in a section 197 transfer are known and prohibitive, the client may be stuck with one contractor in perpetuity, or have to consider doing the work itself as no-one else will be prepared to tender for the work.

There are clearly practical difficulties for the tendering contractor if section 197 applies in the context of second generation contracting-out. However, if we are to realise the purpose of section 197 should we not start thinking of ways of remedying what are not insurmountable problems? It *is* problematic that the incumbent contractor is a source of information relating to its employees' terms and conditions of employment and other potential liabilities for the tenderer. However, that person is not the only source of that information. It may be known to the client, the trade union and, of course, the employees. It is also noteworthy that it is obviously in the client's interests to be able to secure the best service provider with the least disruption. That should prompt the client to be proactive in ensuring that those tendering for a contract are in the best possible position to do so, including knowing what

¹⁶ Du Toit in Todd, Du Toit and Bosch *Business Transfers and Employment Rights in South Africa* (2004) 193.

¹⁷ *Ibid.*

they might be in for with regards to a section 197 transfer. Thus, a client might make it a term of the service provision contract that when the contract is to be put out to tender there is an obligation on the existing contractor to provide prescribed information to those wishing to tender for the contract. Or, if the legislature deemed it necessary, section 197 could be amended to introduce a requirement that the incumbent contractor make the necessary information available to those tendering for the contract.

There is precedent for that in the revised British Transfer of Undertakings (Protection of Employment) Regulations 2006. Regulation 11 makes it compulsory, where there is a change in service provision, for a transferor to disclose “employee liability information” to the transferee. Such information includes: terms and conditions of employment, disciplinary action taken against an employee, or grievances instituted by an employee, as well as information relating to any court or tribunal case that the transferor reasonably believes the employee might bring against the transferee arising out of his or her employment with the transferor. While this might help the “transferee” that person is referred to in the regulations as “the person who carries out the activities prior as a result of the service provision change”.¹⁸ That indicates that the transferee is the person who has already been awarded the contract. It is thus debatable how useful the obligation to disclose the specified information is for a person tendering for a contract. I would suggest that if a similar provision were to be introduced in South Africa it would have to require that the above-mentioned information be disclosed to all those who are tendering for the relevant contract.

It should also be borne in mind that section 197 provides some flexibility to the parties affected by a section 197 transfer. A contractor might tender for a contract on the basis that it will take on the employees of the outgoing contractor on their existing terms and conditions and then, before it actually starts to provide the relevant service, enter into negotiations with the relevant trade union in order to alter the consequences of section 197 by utilising the section 197(6) agreement. It is perhaps significant that such an agreement can be entered into without the co-operation of the old employer. And section 197(3) allows a new employer, without an agreement with the affected employees, to offer different terms and conditions, provided they are on the whole not less favourable than those the employees had with the old contractor and not dealt with in a collective agreement. It is also worth recalling that, even if new employers have to take on the incumbent employees on their prevailing terms and conditions, those are not immutable. Employers in South Africa are entitled to attempt to change their employees’ terms and conditions after transfer by negotiation, power play and ultimately, (somewhat more controversially) in light of the decision in *Fry’s Metals*,¹⁹ operational requirements dismissals. Section 197 thus creates only a temporary buffer against changes to terms and conditions.²⁰

¹⁸ Regulation 2.

¹⁹ *Fry’s Metals (Pty) Ltd v National Union of Metalworkers of SA* 2003 ILJ 133 (LAC), confirmed on appeal in *NUMSA v Fry’s Metals (Pty) Ltd* 2005 26 ILJ 689 (SCA).

²⁰ Benjamin 2005 (2) *Law, Democracy & Development* 179.

3 4 Fair competition and employee protection

It might be argued that section 197 should not apply to second generation contracting-out because, if it did, the service provision industry would be disproportionately adversely affected in relation to the protection afforded transferring employees. That might be because competition is affected if new contractors are required to take over the employee liabilities of former contractors. As pointed out above, the provisions of section 197 can be utilised to manage the disadvantage that might otherwise accrue to incoming contractors. In addition, I do not know of any evidence that shows a marked decline in the service provision industries in European countries where legislation similar to section 197 has been in force for a long time. In fact, when discussing imminent changes to the Transfer of Undertakings regulations in Britain, the Department of Trade and Industry (DTI) stated that, in its view, the new regulations²¹ would:

“[H]elp to create a ‘level playing field’ for contract bids and promote fair competition, encouraging bona fide potential bidders (including small firms) to become involved in service contracting while deterring ‘cowboys’ who would seek to compete by cutting employees’ terms and conditions”.²²

And when discussing the reasons for the requirement that employee liability information be disclosed the DTI stated that:

“[T]he intended effect of the measure is to increase transparency for the transferee as well as for the employees, and to reduce the number of cases in which the transferee feels obliged to seek commercial indemnities from the transferor to afford cover against exposure to unforeseen liabilities. In cases where no commercial indemnities are or would be agreed, the measure will protect the transferee, and indirectly its employees, against acquiring such unforeseen liabilities and suffering adverse consequences – including potentially, in extreme cases, insolvency – as a result. The measure also aims at increasing competition as it introduces a strong disincentive to hide any relevant information about a business to be transferred. This might have an effect on the price of a business. If there are significant unusual liabilities toward employees this would reduce the price. This benefit to the transferee would be a cost to the transferor”.²³

The consequences for employees if section 197 did not apply would be severe in terms of a loss of employment security²⁴ and the erosion of their terms and conditions of employment. It is conceivable that prospective contractors will tender on the basis of reduced labour costs and the terms and conditions of employees doing the same jobs at the same place year after year will be systematically whittled down with each successive service contract. I would urge that we, like the United Kingdom government, should be concerned at the prospect of contractors being able to compete by cutting labour costs as opposed to cutting other costs or improving efficiency.

²¹ British Transfer of Undertakings (Protection of Employment) Regulations 2006.

²² Employment Relations Research Series No. 48, 2005, Compendium of Regulatory Impact Assessments Volume 2 20.

²³ Employment Relations Research Series No. 48, 2005, Compendium of Regulatory Impact Assessments Volume 2 25.

²⁴ Benjamin 2005 (2) *Law, Democracy & Development* 177.

In addition, there is a possibility that employees affected by second generation contracting-out could claim that they have been unfairly discriminated against if section 197 does not apply to protect them. It is suggested that those arguing that section 197 should not apply to second generation contracting-out would be hard-pressed to show that there is a significant difference between initial outsourcing (where, it is accepted, section 197 can certainly apply) and second generation contracting-out such as to justify excluding the application of section 197. In both cases a “business” has moved from one employer to another as a going concern. The distinction is arbitrary. It appears even more arbitrary if one accepts that one case involving second generation contracting-out could fall within section 197 if there is some transaction between the two contractors that facilitates the transfer of a business as a going concern, whereas another will not, because the business has transferred to the incoming contractor as a going concern but not by the efforts of the outgoing contractor.

3 5 Comparative law

The trend internationally²⁵ has been to ensure that second generation contracting-out is covered by the relevant protective legislation. In Europe there have been difficulties relating to when relevant legislation applied to changes in service provision. The response from the United Kingdom Parliament was to introduce new legislation that delineated a broad scope for the application of the relevant legislation.²⁶ The new regulations apply, *inter alia*, to all “service provision changes”²⁷ provided that prior to the service provision change there was an organised grouping of employees which has as its principal purpose carrying out the relevant activities for the client and that the activities will not, following the service provision change, be carried out in connection with a single specific event or task of short-term duration. There is no requirement that the relevant entity retain its identity

²⁵ In New Zealand, the Employment Relations Act 24 of 2000 has recently been amended to include provisions aimed at protecting specified categories of vulnerable employees in situations where “their employer proposes to restructure its business so that their work is to be performed for a new employer” (s 69A). In those cases the employees will, *inter alia*, be given an election to transfer to the new employer on the same terms and conditions of employment. “Restructuring” is defined as follows:

- “(i) entering into a contract or arrangement under which the employer’s business (or part of it) is undertaken for the employer by another person; or
- (ii) selling or transferring the employer’s business (or part of it) to another person; or
- (iii) the termination of a contract or arrangement referred to in subparagraph (i) if the work carried out under the contract or arrangement is to be carried out by another person, whether by a new person or by the person for whom the employer carried out the work” (s 69B).

²⁶ The Transfer of Undertakings (Protection of Employment) Regulations 2006 were introduced in April 2006 after extensive consultation and debate.

²⁷ These are defined (in regulation 3) as situations in which activities cease to be carried out by a client and are carried out instead by a contractor on the client’s behalf; or where activities cease to be carried out by a contractor on a client’s behalf and are carried out instead by another person on the client’s behalf; or where activities cease to be carried out by a contractor on a client’s behalf and are carried out instead by the client on his own behalf.

after the service provision change. Essentially, all that is required is a change in the person carrying out the relevant activity.

It is not suggested that we, in South Africa, resort to accepting that section 197 will apply whenever there is a change in the person providing a client with a service, although in *SA Municipal Workers Union v Rand Airport Management Co (Pty) Ltd*²⁸ the Labour Appeal Court came very close to doing exactly that. The need to amend the regulations in the United Kingdom arose out of seemingly conflicting decisions emerging from the European Court of Justice that, in turn, led to contradictory decisions by the national courts tasked with applying them. The remedy adopted by the legislature was to make their regulations applicable to practically every change in service provision. But there need not be similar confusion here.²⁹ Our courts are not bound to follow the European courts, but should be guided by their experience. They have the advantage of being able to draw on the European experience and can take what is most useful and avoid the potential pitfalls highlighted by experience. The results of the application of the test for transfer as a going concern are going to depend to a large extent on the circumstances of a particular case, but there is no reason why the test cannot be applied consistently whether to business sales, or initial or subsequent contracting-out. A mere change in service provision, it is submitted, is not necessarily sufficient to trigger the application of section 197 in light of the test for the transfer as a going concern formulated by the Constitutional Court.³⁰ That requires an examination of all the components of a business in order to determine whether the business has transferred for the purposes of section 197. No single factor is determinative. In addition, that test indicates that a “business” cannot be reduced to one of its components, for example the opportunity to work for a particular client.

3 6 The importance of a purposive interpretation

An important consideration in *Zikhethele* was the courts’ obligation to adopt a purposive approach to the interpretation of section 197. That obligation is apparent from section 39(2) of the Constitution, which requires courts to promote the spirit, purport and objects of the Bill of Rights when interpreting legislation. That is emphasised by the LRA itself, which states that one of the primary objects of the Act is to give effect to the right to fair labour practices. It is also stipulated that the Act must be interpreted to give effect to its primary objects and the Constitution.³¹ The court in *Zikhethele* found that

²⁸ *Supra*. See the comments on this decision in fn 1 above.

²⁹ Wallis appears to assume that is inevitable when he argues that the “European experience suggests that it may well be appropriate to limit the scope of [provisions like s197] because of the anomalies and confusion to which the broader approach gives rise” (2006 27 *ILJ* 16). It is debatable whether limiting the scope of s 197 is going to reduce uncertainty and confusion in its application. The confusion around the application of s 197 prior to its amendment in 2002 is evidence of that.

³⁰ *NEHAWU v University of Cape Town supra* 119-120.

³¹ See ss 1 and 3 of the LRA. See also *NEHAWU v University of Cape Town supra* 113-114; and *Ceramic Industries Ltd t/a Beta Sanitary Ware v NCBAWU (2)* 1997 18 *ILJ* 671 (LAC) 675.

reading “by” as “from” would ensure that employees affected by first and second generation contracting-out would receive the same protection. That conclusion would, in the court’s view, “promote the spirit and advance the purport of equal treatment and fair labour practices”.³² In support of a purposive approach to the interpretation of the LRA, one judge suggested, with reference to section 3, “that the statute should be read in order to achieve its purposes and that any infelicity of language should not stand in the way of this”.³³

The approach adopted by the court in *Zikhethele* might find support in the decision of the Labour Appeal Court in *Wyeth SA (Pty) Ltd v Manqele*.³⁴ In that case the court was required to determine whether a person who had concluded a contract of employment with an employer, but had not yet commenced work, fell within the definition of “employee” in the LRA. The Labour Appeal Court held that the “golden rule” of interpretation³⁵ is the starting point in interpreting a statute but noted that the LRA and the Constitution require that it be interpreted in compliance with the Constitution and concluded that:

“Given the resultant gross hardship, ambiguity and absurdity in the adoption of the literal interpretation, I am of the view that this Court is thus entitled to depart from such a literal and ordinary construction and extend the literal construction of the definition [of employee] as including a person who has concluded a contract of employment which is to commence at a future date. Common sense, justice and the values of the Constitution would, in my view, best be served by extending the literal construction to include such a person.”

In *NUMSA v Bader Bop (Pty) Ltd*³⁶ O’Regan J noted that:

“[If the LRA] is capable of a broader interpretation that does not limit fundamental rights, that interpretation should be preferred. This is not to say that where the legislature intends legislation to limit rights, and where that legislation does so clearly but justifiably, such an interpretation may not be preferred in order to give effect to the clear intention of the democratic will of parliament. If that were to be done, however, we would have to be persuaded by careful and thorough argument that such an interpretation was indeed the proper interpretation and that any limitation caused was justifiable as contemplated by s 36 of the Constitution.”

That suggests that if the interpretation adopted by the court in *Zikhethele* is one that the provisions of section 197(1)(b) can bear it should be preferred, as opposed to one that is more “mechanical”.

³² *Supra* 932.

³³ *NUMSA v CCMA* [2000] 11 BLLR 1330 (LC) par 34.

³⁴ [2005] 6 BLLR 523 (LAC).

³⁵ In *Adampol (Pty) Ltd v Administrator, Transvaal* 1989 3 SA 800 (A) 804 this rule was stated as follows: “According to the golden or general rule of construction, the words of a statute must be given their ordinary literal and grammatical meaning and if by so doing it is ascertained that the words are clear and unambiguous, then effect should be given to their ordinary meaning unless it is apparent that such a literal construction falls within one of those exceptional cases in which it would be permissible for a court of law to depart from such a literal construction, eg where it leads to a manifest absurdity, inconsistency, hardship or a result contrary to the legislative intent.”

³⁶ 2003 24 ILJ 305 (CC) par 37.

The courts have also pronounced on the particular purposes of section 197. In *NEHAWU v University of Cape Town* the Constitutional Court stated, viewing section 197 through the lens of the right to fair labour practice, that the section does not have a single purpose. Rather,

“Its purpose [rather] is to protect the employment of the workers and to facilitate the sale of businesses as going concerns by enabling the new employer to take over the workers as well as other assets in certain circumstances. The section aims at minimizing the tension and the resultant labour disputes that often arise from the sale of businesses and impact negatively on economic development and labour peace. In this sense, section 197 has a dual purpose; it facilitates the commercial transactions while at the same time protecting the workers against unfair job losses”.³⁷

Section 197 protects workers in that the transfer of a business may not be used as a basis to retrench workers or reduce their terms and conditions of employment.³⁸ That is, the employees cannot be told that they are no longer required by the transferor employer and be dismissed, having to go cap-in-hand to the transferee begging for employment on whatever terms that person sees fit to offer. The thrust of section 197, it is submitted, is essentially that employees are entitled to continue in employment, on the same terms and conditions, when the business in which they work is transferred to another employer and after transfer it remains essentially the same business. If the business continues, so should the employees' employment in it. Loss of employment in those circumstances would amount to the kind of “unfair job losses” alluded to by the Constitutional Court. If one accepts this view of section 197, in determining its applicability the mode or method of transfer is of less importance than whether the business in question has transferred as a going concern.³⁹ This approach is in keeping with that of the European Court of Justice which has stated repeatedly that:

“[The aim of the Directive] is to ensure continuity of employment relationships within an economic entity, irrespective of any change of ownership. The decisive criterion for establishing the existence of a transfer within the meaning of the directive is, therefore, whether the entity in question retains its identity ...”⁴⁰

It is submitted that it is not necessary to be too cautious in resorting to the guidance offered by foreign jurisprudence with respect to the proper interpretation and application of section 197. Granted, there are important

³⁷ 118. In this respect s 197 differs from the European legislation that inspired and informed its contents. The European Directives 77/187/EEC and 2001/23/EC were introduced to bring about “the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses, or parts of undertakings or businesses” To give effect to the Directives the British parliament introduced the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) the intention of which is clear from its title.

³⁸ Benjamin 2005 (2) *Law, Democracy & Development* 170.

³⁹ *COSAWU v Zikhethale Trade (Pty) Ltd supra* 935.

⁴⁰ *Abler v Sodexho MM Catering Gesellschaft mbH C-340/01*, 20 November 2003 par 29; *Suzen v Zehnacker Gebaudereinigung GmbH Krankenhausservice* [1997] IRLR 255 (ECJ) par 10.

differences between the wording of the respective pieces of legislation⁴¹ and the contexts in which they were drafted. However, relevant foreign case law should be accorded its proper weight, bearing in mind that European jurisprudence in particular was a source of inspiration and guidance in the drafting of our section 197. In addition, our courts have widely endorsed the utilisation of European jurisprudence as a lodestar in the application of our section 197.⁴²

Of course, the purposive interpretation of legislation does not entitle the courts to read legislation in any way they choose.⁴³ As the Labour Appeal Court has stated, “there is a limit to which the wording of a statute or rule may be disregarded in the process of the application of purposive interpretation”.⁴⁴ As Du Toit has pointed out:

“[The] true conflict [regarding the interpretation of s 197(1)(b)] ... lies essentially between the view that the purpose of a statute is merely another interpretive aid to which the court may have recourse in the event of textual ambiguity as opposed to the view that the purpose of legislation, construed on the basis of the Bill of Rights, is of primary importance and may prevail over its literal meaning to the extent of rendering the latter null and void ('unconstitutional').⁴⁵

Thus, the fundamental question is to what extent a purposive interpretation justifies a departure from a strict reading of section 197(1)(b) of the LRA in order to give effect to employees' fundamental rights, the purpose of the LRA and, as suggested above, the purpose of section 197 itself. It may support an interpretation of section 197(1)(b) such as that adopted by the court in *Zikhethele*. If not, the section is open to constitutional challenge.

3.7 Similar situations

It is worth noting that the consequences of a narrow interpretation of section 197(1)(b) extend beyond second and further generation transfers. That is best illustrated by the following examples.

- 1 The governing body of a golf course outsources the management and maintenance of the course. The employees who worked for the governing

⁴¹ Although in his dissenting judgment in *NEHAWU v University of Cape Town* [2002] 4 BLLR 311 (LAC), Zondo JP emphasised the distinct similarities between s 197 and relevant foreign legislation. See the discussion 316-324 and 327-332.

⁴² See for example, *NEHAWU v University of Cape Town supra* 116-117; *SA Municipal Workers Union v Rand Airport Management Co (Pty) Ltd supra* 81-83; *Transport Fleet Maintenance (Pty) Ltd v NUMSA* [2003] 10 BLLR 975 (LAC) 980; *Foodgro (A division of Leisureniet Ltd) v Keil* [1999] 9 BLLR 857 (LAC) 879-882; *Schutte v Powerplus Performance* 1999 20 ILJ 655 (LC) 665; *Ndima v Waverley Blankets Ltd* [1999] 6 BLLR 577 (LC) 586-587.

⁴³ *S v Zuma* 1995 2 SA 642 (CC) 653-654.

⁴⁴ *Xaba v Portnet Ltd* [2000] 1 BLLR 55 (LAC) 62.

⁴⁵ Du Toit unpublished paper presented at the XVIII World Congress of the International Society for Labour and Social Security Law, Paris, September 2006 16-17. See also the thought-provoking discussion in De Ville *Constitutional and Statutory Interpretation* (2000), Interdoc 33-51 and 250-254.

body transfer to the contractor who assumes responsibility for the golf course and operates it using the equipment owned by the governing body. However, at the end of the contract the governing body decides that it wishes to resume its initial responsibilities.

- 2 X was awarded a contract to manage the catering service in a hospital including providing patients and staff with meals and drinks. Meals were prepared on the hospital premises. The premises, water, electricity and necessary equipment were provided by the hospital. The relationship between X and the hospital was terminated and X failed to secure the contract when it was put out to tender. The contract to manage the catering services at the hospital went instead to Y, which refused to take over X's materials, stock and employees.
- 3 A city has a population of 170 000 and a significant amount of industry has been established there. The city authorities decide to establish a waste disposal plant to address problems that are being experienced in the disposal of household and industrial waste. To that end a piece of land is selected as a site for the plant and tenders are sought from the waste disposal industry. Company A is successful and a contract is concluded between A and the city. The agreement provides that A will be granted the use of the land for 99 years and is authorised by the city to run a waste disposal plant at the site to dispose of household waste. A erects the necessary buildings. The plant is to be run by a subsidiary of A, company B. B leases the land and buildings from A. The employees, machinery and other equipment to be used in the plant are supplied by B. After a year A decides that it no longer wishes to be involved in the waste disposal industry and the city again seeks tenders for the running of the plant. Company C is the successful party and receives authorisation from the city to dispose of household waste. The city terminates its contract with A and C is granted the use of the land for 99 years. In addition, C buys the buildings from A and the machinery and other equipment from B. The business of the waste disposal unit is thus transferred to C via contracts with the city, A and B.
- 4 A motor vehicle manufacturer (A) sells a fleet of delivery vehicles to a customer (B). It also offers an additional service, for a fee, in the form of providing a staff (specialist technicians and management) to run a vehicle maintenance depot on the premises of the customer. B supplies the premises, vehicle parts and most of the equipment. After two years this arrangement is terminated by B who contracts with C to do what A was doing.

All of these situations might be excluded from the application of section 197 if one were to adopt a narrow construction of section 197(1)(b). They illustrate circumstances where the transfer is not "by" the efforts of the old employer, but is facilitated by another party or other parties. However, in each case the outcome is that the relevant entity ("business") is shifted from one employer to another employer as a going concern. If that is in substance what happens, section 197 should apply. The scenarios sketched above raise questions relating to whether the old employer must be the owner of

what is transferred. That debate is not one that can properly be dealt with here. However, it is suggested that the test should be whether the business entity that is transferred was under the control or in the possession of the old employer. In that sense it is taken “from” the old employer when the business is transferred away, ultimately to resort with the new employer. The situations sketched above also raise questions relating to whether the employees were part of the relevant entity and would thus be transferred with it. That, too, is not a question that can adequately be dealt with here, but has been considered elsewhere.⁴⁶ What the scenarios demonstrate is that a failure to adopt a broader interpretation of section 197(1)(b), or to amend it in order to make it constitutionally compliant, has potentially undesirable implications beyond the realm of second generation contracting-out.

4 CONCLUSION

The decision of the Labour Court in *COSAWU v Zikhethele* has given rise to a debate around the application of section 197 to so-called second generation contracting-out. The court found that a purposive approach to the interpretation of section 197(1)(b) entailed that section 197 will apply when there is a transfer of a business “from” the old employer to the new employer as a going concern. That means that the section can apply in cases where the effect of a transaction, or transactions, is to shift a business to a new employer, regardless of whether the old employer is an active participant in that shift.

Some commentators have been highly critical of this, arguing that the approach of the court goes beyond the limits of purposive interpretation and completely ignores the clear wording of section 197(1)(b). They have also referred to the difficulties that might arise if section 197 is found to apply to second generation contracting-out as a basis to argue that the section should not apply to such transfers. It is suggested above that we need to apply our minds to what we are trying to do with section 197, that is, to consider what kinds of situations we wish it to cover. It is submitted that the section was intended to apply to situations where a new employer takes over a “business” as a going concern, that is, continues with the same activity at the same place, using the same or similar equipment, with the work being done by the same employees for the same customers, *etcetera*. If that is so, how the shift to the new employer is effected is less important and there is less of a need to insist on a mechanical reading of section 197. I have also suggested above that an interpretation of section 197 that extends it to second generation contracting-out is in keeping with the rights to fair labour practice and equality of employees affected by such transfers. If the courts can interpret section 197(1)(b) in a manner that gives effect to those rights then that should be done. But that depends on where the bounds of purposive interpretation lie.

⁴⁶ Bosch “Of Business Parts and Human Stock: Some Reflections on Section 197(1)(a) of the Labour Relations Act” 2004 25 *ILJ* 1865.

I have suggested that if the courts insist on the old employer actively transferring the business as a going concern because that is what the wording of section 197(1)(b) requires, that provision is probably not going to pass constitutional muster. There does not seem to be a sound rationale on which to base a distinction between business transfers involving first or second and further generation contracting-out and it is suggested above that such a distinction is arbitrary and unsustainable. Finally, it is worth recalling that second generation contracting-out transfers are not the only transfers where the old employer might not be active in transferring the relevant business entity as a going concern. That might also be the case where a client, having outsourced a service, decides to resume that activity. It is difficult to imagine why section 197 should not apply in those circumstances, other than due to the barrier supplied by "by" in section 197(1)(b).