

# **SOUTHERN AFRICAN BUS OPERATOR'S ASSOCIATION CONFERENCE 2012**

## **DEALING WITH SECTION 197 LABOUR ISSUES IN A CONTRACTING ENVIRONMENT**

### **1. INTRODUCTION**

1.1 Section 197 of the Labour Relations Act ("the Act") deals with the legal consequences of the transfer of the whole or a part of any business trade undertaking or service as a going concern. In essence if a transfer as a going concern occurs there is an automatic transfer of employees to the new employer. All the rights and obligations between the old employer and any employee at the time of transfer continue in force as if they had been rights and obligations between the new employer and the employee, anything done before the transfer in relation to the old employer is considered to have been done by or in relation to the new employer, and the transfer does not interrupt an employee's continuity of employment.

1.2 The clear intention of section 197 is to protect jobs and terms and conditions of employment where there is a transfer of a business as a going concern. The question as to what constitutes a transfer of a business as a going concern has been the subject matter of litigation over the years. An issue which has been considered by the courts is whether the outsourcing of a component of a business amounts to a transfer of a business as a going concern. The Labour Appeal Court some years ago found that an outsourcing contract was covered by section 197<sup>1</sup>. Whether section 197 would apply to the subsequent awarding of contracts to other service providers however remained a contentious issue which was resolved in a judgment of the Constitutional Court late last year<sup>2</sup>.

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<sup>1</sup> NEHAWU v University of Cape Town [2003] 5B LLR 409(CC)

<sup>2</sup> The Aviation Union of South Africa and the South African Transport and Allied Workers' Union v South African Airways (Pty) Limited and LGM South Africa Facility Managers and Engineers (Pty) Limited and Allan and 204 Others

1.3 I intend to deal today with the recent Constitutional Court judgment delivered late last year which has far reaching implications for businesses involved in a contracting environment. I will also deal with a Labour Court judgment delivered at the end of December last year which applied the Constitutional Court reasoning to the award of a contract in circumstances where there had not been outsourcing in the first place<sup>3</sup>. I will then consider the implications of these developments in the law relating to s 197 on the contracting environment.

## **2. THE RECENT JUDGMENTS**

2.1 The Constitutional Court judgment dealt with a situation in which South African Airways (“SAA”) terminated an agreement with a service provider LGM. The services had originally been carried out by SAA and had been outsourced to LGM.

2.2 On termination of the agreement with LGM the services were to be provided to SAA by a new contractor and LGM indicated to the unions that it intended to retrench all the workers who would be rendered redundant by reason of the termination of the agreement by SAA. The unions approached the Labour Court for declaratory relief to the effect that the termination of the agreement and subsequent provision of those services by a new contractor was a transfer in terms of section 197 of the LRA.

2.3 If section 197 did apply then the employees would continue in employment on the same terms and conditions as previously applied but with the new contractor. If section 197 did not apply the employees would be retrenched. The Labour Court held that section 197 did not apply as the section required a transfer “by” the old employer which it held was SAA and as the services were not transferred “by” SAA but “from” LGM section 197 did not apply.

2.4 The Labour Appeal Court overturned the decision and held that section 197 did apply.

2.5 In the Supreme Court of Appeal the majority agreed with the interpretation of

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<sup>3</sup> Harsco Metals South Africa (Proprietary) Limited & Another v ArcelorMittal South Africa Limited & Others. As yet unreported Labour Court Case Number J 2923/11

the Labour Court and held that section 197 did not apply.

2.6 In the Constitutional Court there was a split of 6 to 5 of the 11 Constitutional Court judges. The majority and minority agreed that the purpose of section 197 was to change the common law situation in line with the constitutional right to fair labour practices, and to safeguard worker's security as well as to facilitate the smooth transfer of a business by guaranteeing the employer a workforce to continue the business. Both the majority and minority judgments in the Constitutional Court rejected the argument that the use of the words "by one employer ... to another employer ..." excluded the application of the section to so called "second generation outsourcing".

2.7 The Constitutional Court rejected the contention that outsourcing should be treated differently from other transfers. In the majority judgment it was stated that:

*"An inquiry whether a transaction falls under the terms of section 197(1) and (2) would be misleading if it focuses solely or mainly on the generation of the transfer. It has the potential to bring about an incorrect result. It does not matter in principle what the generation of the outsourcing is, or even whether the transaction is concerned with contracting out at all. The true inquiry is whether there has been a transfer of a business as a going concern by the old employer to the new employer." (my emphasis)*

2.8 The Constitutional Court confirmed that the inquiry as to whether there has been a transfer of a business as a going concern by the old employer to the new employer is a matter of fact to be determined objectively and which involves an inquiry into:

- 1) the existence of a transfer;
- 2) whether there was a transfer of a business; and
- 3) whether the business is transferred as a going concern.

In this regard the Constitutional Court endorsed the approach which it had

adopted in its earlier decision in NEHAWU v University of Cape Town. The split in the Constitutional Court related only to whether on the facts before it there had been a transfer as a going concern. The majority found that there had been whereas the minority preferred to remit the matter back to the Labour Court to make a factual finding.

2.9 In the majority judgment in the SAA Constitutional Court matter there is an important passage which appears to suggest that if the initial transaction did not involve the transfer of a business as a going concern then the cancellation of that contract and the awarding of the contract to another service provider does not attract the operation of section 197. The court said the following:

*“If the outsourcing institution from the outset did not offer the service, that service cannot be said to be part of the business of the transferor. What happens is simple contracting out of the service, nothing more, nothing less.*

*There is no transfer of the business as a going concern. The outsourcee is contracted to provide the service, and it becomes obliged to do so. And it is the outsourcee’s responsibility to make appropriate business infrastructure arrangements. These may include securing staff, letting appropriate property for office or other work space, and acquiring fixed assets, machinery and implements, computers, computer networks and the like. Cancellation of the contract in these circumstances entails only that the outsourcee forfeits the contractual right to provide the service. The whole infrastructure for conducting the business of providing the outsourced service would ordinarily remain the property of the outsourcee. As we shall see, that is not what happened here, either when the initial outsourcing contract was concluded between SAA and LGM, or when SAA cancelled it.*

*If, on the other hand, the first outsourcing exercise is really a transfer of part of the business of the outsourcer who has been carrying on the business of the provision of the service until transfer, the question whether the subsequent transfer is merely the transfer of the right to provide the outsourced service or the transfer of a business as a going*

*concern would arise. And that would require an analysis of the terms of transaction that gives rise to the subsequent event.”*

2.10 Subsequent to the Constitutional Court decision the Labour Court in late December last year had to consider an urgent application relating to the termination of a contract by ArcelorMittal and the award of a contract to another service provider.

2.11 The facts of the recent Labour Court judgment are briefly as follows:

2.11.1 the outgoing service provider Harsco provided services to ArcelorMittal relating to the management and processing of slag, a by-product of smelting ore. For these purposes Harsco operated a number of metal recovery plants and crushing and screening plants at various ArcelorMittal factories. The services had been provided for approximately 40 years;

2.11.2 ArcelorMittal initiated a tender process. Harsco was unsuccessful in its bid and the contracts which had been previously held by Harsco were awarded to a new service provider;

2.11.3 as part of the tender transactions ArcelorMittal would purchase certain assets from Harsco which had been used in the provision of the services, some of which would be sold to the new service provider which would in addition inject a capital investment of some R500 million in capital expenditure;

2.11.4 the new service provider extended offers of employment to the majority of the outgoing service provider's employees;

2.11.5 none of the parties appear to have contemplated that the award of the contract to a new service provider would be covered by section 197. Harsco in fact engaged in consultations with the trade unions relating to a retrenchment of its employees due to the termination of its contracts with ArcelorMittal;

2.11.6 when the SAA Constitutional Court judgement was published, Harsco

instituted an urgent application in the Labour Court seeking an order declaring that the termination of its contracts and the awarding of the new contracts to the new service provider was covered by section 197;

2.12 The Labour Court considered that the fact that the new service provider would not take over all the plant and assets relating to the contract from the old service provider was important, but was not in itself over riding as to whether there was a transfer of a business as a going concern.

2.13 The Labour Court found that the factual circumstances to be taken into account in determining whether the conditions of a transfer of a whole or part of a business as a going concern for the purposes of section 197 are primarily:

2.13.1 the degree of similarity of the activity carried on before and after the transfer; and

2.13.2 the type of undertaking concerned; and

2.13.3 the question whether or not the majority of employees are to be taken over by the new employer.

2.14 On the facts before it, the Labour Court found that the termination of the contracts with the outgoing service provider and the award of the contracts to the new service provider in circumstances where the majority of employees were offered employment with the new service provider fell within the ambit of section 197.

2.15 The Labour Court judge considered what would have avoided the matter being found to be a transfer in terms of section 197 and said:

*“It remained open to Phoenix and Tube City to employ none of Harsco’s employees, and to decline to take transfer of any of Harsco’s assets. In this event, my conclusion would have been different and there would I think have been no more than the termination of one contract and the beginning of another.*

*But that is not what occurred.”*

### **3. THE IMPLICATIONS OF DEVELOPMENTS IN THE LAW OF SECTION 197 ON THE CONTRACTING ENVIRONMENT**

3.1 In the light of the case law, the factual circumstances pertaining to a transfer need to be carefully evaluated to determine whether or not it constitutes a transfer of a business as a going concern within the meaning of section 197.

3.2 It is clear from the recent Labour Court judgment that if there is no transfer of employees and no transfer of assets that section 197 does not apply.

3.3 What is not clear is where the courts will draw the line which will trigger section 197 becoming applicable if some employees and some assets are taken over. If for example the new contractor employs only 10% or 20% of the previous contractor's employees and acquires some assets whilst not taking over the bulk of equipment required for the performance of the contract, will this be sufficient to bring the transaction within the scope of section 197? It remains to be seen where in respect of a particular transaction involving the employment of some employees and the acquisition of some assets where the courts will decide the cut off will be which brings the transaction within the scope of section 197.

3.4 In the transport industry there are bus operators which are involved in private commercial transactions. There are also bus operators which provide public passenger bus services in terms of contracts with various provincial departments of transport.

3.5 In the case of a private commercial contract it is apparent from the recent Labour Court judgement in the Harsco matter that if a bus operator is awarded a contract and takes over the majority of the previous contractor's employees and some assets that the awarding of the contract to that bus operator could constitute a transfer of a business as a going concern within the meaning of section 197. To avoid those consequences the Labour Court has clearly stated that if the bus operator does not take over employees or assets, the transaction will not be subject to section 197.

- 3.6 In terms of the National Land Transport Act<sup>4</sup>, there is provision for commercial service contracts, negotiated contracts and subsidised service contracts. Depending on the factual circumstances section 197 could be of application to all of these forms of contract. Section 197 could also impact upon sub-contracting arrangements which bus operators may enter into for the provision of services. In each case a factual determination will be required to determine whether s 197 is of application.
- 3.7 A tender process can also give rise to a transaction which could fall within the scope of section 197. A bus operator will need to give careful consideration as to whether or not to submit a bid for a tender where the tender requirements oblige a successful bidder to take over all or some of the employees or assets of the outgoing contractor as that could bring the termination of the contract with the previous service provider and the award of the tender contract to the new contractor within the scope of s 197.
- 3.8 Whilst no one would dispute that employees should be protected in a transfer of a business, there are however potential negative aspects of section 197 which can also be considered. For example if a service provider could not fulfil its obligations because of excessive levels of theft and pilfering by its workforce, a replacement service provider could if section 197 applied be forced to continue with the same problematic workforce which could be prejudicial to the public using that service.
- 3.9 It should be borne in mind that if section 197 applies, there is an automatic transfer of employment and of existing terms and conditions of employment. This has important implications for a bus operator in determining whether its tender bid will, if awarded to it be commercially viable. For example if a bus operator submits a tender in which it has calculated its wage bill on the basis of the minimum South African Road Passenger Bargaining Council wage levels, it could be faced with financial ruin if the outgoing service provider employed its employees at higher wages which it cannot afford. What impact section 197 will have on encouraging the development of small business remains to be seen. In addition if a successful bidder finds they have excess employees as a consequence of an unexpected application of section 197

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<sup>4</sup> National Land and Transport Act 2009

they may have to retrench employees.

3.10 Whilst the protection of employees and of their rights is laudable in a transfer situation, section 197 can have serious financial consequences if a tender bidder has not adequately evaluated its bid. Whether section 197 has unforeseen social and business consequences such as the protection of existing employees at the expense of prospective employees who may have obtained employment with a new contractor if that contractor was not obliged to take over an outgoing contractor's employees and whether it will result in value for money being achieved by state entities falls outside of the legal ambit of which I have discussed today. There are also practical difficulties which will arise. If for example an existing contract is split into integrated components with the services split between buses and taxis, this could prove problematic.

3.11 In conclusion, depending on the particular factual circumstances, bus operators need to be aware of the implications of section 197 and to carefully assess the factual situation so as to avoid finding that they have as a matter of law become the employer of the outgoing service provider's employees. This is particularly so as the courts have not yet made clear where they will draw the line which triggers the applicability of section 197 where some employees and assets are taken over by a new service provider.