Section 197, second generation outsourcing and service transfers: the future of Section 197 in South Africa - an update
Anastasia Vatalidis and Bradley Workman-Davies, Directors

Since its introduction into the amended Labour Relations Act, 66 of 1995 (the LRA) in 2002 and the pronouncement on its application by the Constitutional Court in the case of National Education Health & Allied Workers Union (NEHAWU) v University of Cape Town & Others (2003) (CC), labour and commercial practitioners are familiar with Section 197 as having application to transfers of businesses. The provisions relating to employees and their transfer in terms of Section 197 are also common in commercial transactions.

In short, in terms of Section 197, if a business, trade, undertaking, or service, or part thereof is transferred as a going concern, unless otherwise agreed:

- the old employer is automatically substituted by the new employer in respect of all contracts of employment in existence immediately before the date of transfer;
- all the rights and obligations between the old employer and an employee at the time of the transfer continue in force as if they had been the rights and obligations between the new employer and the employee;
- anything done before the transfer by or in relation to the old employer (including the dismissal of an employee, the committing of an unfair labour practice or an act of unfair discrimination) 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, and an employee’s contract of employment continues with the new employer as if with the old employer.

Section 197: outsourcing and second generation outsourcing

What is not as commonly known is that Section 197 has also been confirmed as applying to outsourcing transactions, as well as second generation outsourcing transactions. The NEHAWU v UCT case was itself an instance of outsourcing, and the Constitutional Court confirmed there that Section 197 applied.

In regard to the application of Section 197 to second generation outsourcing, a brief history of the courts’ approach is set out below:

- in Cosawu v Zikethele Trade (Proprietary) Limited and Another (2005) 26 ILJ 1056 (LC), the Labour Court found that where there was a change in the identity of service providers, the second generation outsourcing brought about by such a change could give rise to a transfer of a business as a going concern as contemplated in terms of Section 197 of the LRA. This means that the new service provider steps into the shoes of the old service provider insofar as the employees associated with the business are concerned;
in Aviation Union of South Africa and Others v SAA (Proprietary) Limited, LGM Engineers (Proprietary) Limited and Others, (Labour Court, October 2007) Basson J looked at the wording of Section 197 which reads that the transfer is ‘by one employer to another’ and not ‘from one employer to another’. Basson J found that this wording meant that Section 197 was not intended to apply to second generation outsourcing arrangements. However, despite this finding, Basson J recognised that there may be some circumstances in which a successful tenderer may take automatic transfer of contracts of employment from an unsuccessful contractor in terms of Section 197, and thus that there may be some cases in which second generation outsourcing could attract the consequences of Section 197.

in Crossroads Distribution (Proprietary) Limited t/a Jowell’s Transport v Clover SA (Proprietary) Limited and M G Moko and 17 Others, (Labour Court, November 2007) (unreported), the Labour Court declined to hold that the loss of the contract to perform services and its award to a new contractor amounted to the transfer of a business as a going concern as contemplated in Section 197. Critically, however Revelas J in this case also sided with Basson J’s view that there may be cases in which employees affected by second generation outsourcing transactions may require protection in terms of Section 197;

the decision of Basson J in Aviation Union (LC), was taken on appeal to the Labour Appeal Court in Aviation Union of South Africa obo Barnes and Others v SAA (Proprietary) Limited and Others (2010) 1 BLR 14 (LAC). In that appeal, which is now the leading authority on the subject of second generation outsourcing, the Labour Appeal Court considered the previous decisions and found that when a party cancels a contract with a service provider to which its own employees had transferred in terms of Section 197 of the LRA, the appointment of a new contractor to perform the same services constitutes second generation outsourcing and is subject to the provisions of Section 197 of the LRA. Consequently, the new contractor steps into the shoes of the old contractor insofar as the employees performing the outsourced services are concerned;

the decision of the LAC was taken on appeal to the Supreme Court of Appeals in South African Airways v Aviation Union of South Africa obo Barnes and Others 123/10 [2011] ZASCA 1. The SCA found that Section 197 did not apply to second generation outsourcing, for the reasons put forward by Basson J in the original case at the LC.

Although the Aviation Union (SCA) decision indicates that Section 197 does not apply to second generation outsourcing, recent proposed amendments to the LRA indicate that the wording of Section 197 will be amended to bring second generation outsourcing back within the ambit of what would constitute a transfer of a business as a going concern. The explanatory memorandum to the proposed amendment specifically refers to the purposive interpretation favoured by the LAC, as driving this amendment. As such, despite the SCA judgement, it appears that second generation outsourcing will once again be subject to Section 197 once the proposed amendment takes effect.

As such, an important question which arises is: when is a transaction an outsourcing transaction?

Davis AJA, in SAMWU & Others v Rand Airport Management Company (Proprietary) Limited 2005 (LAC) stated that in the case at hand, he was convinced that the parties had entered into an outsourcing agreement in light of the fact that the agreement before him was one “in terms of which the second respondent undertakes to or is obliged to perform services previously performed by employees of the first respondent”.

Having regard to Davis AJA in SAMWU, whether an agreement amounts to an outsourcing agreement will, arguably, be determined by whether de facto a party undertook to perform services which were previously performed by the other party. If so, the transfer of the performance of those services may amount to outsourcing and may be subject to Section 197. Importantly, the subsequent cancellation of the contract to perform these services, and the award of this contract to another third party may amount to second generation outsourcing and may also be subject to Section 197.

Section 197: future application

An overview of the current application of Section 197 in South Africa indicates that Section 197 will apply in circumstances in which:

there is a transfer of a business, trade, undertaking or part thereof as a going
concern;

as a sub-category of the transfer of an undertaking or part thereof, there is an outsourcing or second generation outsourcing transaction.

However, when one considers how far South African courts have gone to apply Section 197 to outsourcing and second generation outsourcing agreements, it would seem that the door has been opened to allow for the scope and application of Section 197 to be widened even further. This approach appears justifiable, as drawing the line at the application of Section 197 to second generation outsourcing could only be achieved by sophistry and would not give effect to what appears to be Section 197’s recognised purpose. An example illustrates the problem and provides an argument for Section 197 being given extended application:

Scenario 1: Company A employs a handful of security guards to guard its premises. As the company grows and extends its premises, it enters into a contract with a private security firm, Security Firm B, to provide guards for the premises as well as other security services. Recognising that this transaction constitutes outsourcing, Company A transfers its employees who perform guarding services to Security Firm B, and allows Security Firm B to continue with this contract for a number of years. Later, Company A grows dissatisfied with the services provided by Security Firm B, cancels the contract and appoints Security Firm C to perform security and guarding services. Again, recognising that this transaction is subject to Section 197 as a second generation outsourcing transaction, the employees of Security Firm B who perform the guarding services in respect of Company A transfer to Security Firm C.

Scenario 2: the facts of this scenario are exactly the same as those in scenario 1, save for the fact that Company A never employs any of its own employees to perform guarding or security duties, but enters into a contract with Security Firm B to provide these services from the outset. Consequently, there is no outsourcing and no employees transfer from Company A to Security Firm B. When Company A grows dissatisfied with Security Firm B, cancels its contract and concludes a contract for security services with Security Firm C, there is no second generation outsourcing transfer and the employees of Security Firm B do not transfer to Security Firm C.

In scenario 1, the employees of Company A move to Security Firm B, and then the employees of Security Firm B transfer to Security Firm C. In scenario 2, no employees are transferred. The only difference between the scenarios is that in the first, there was an original outsourcing, and in the second, there was no outsourcing.
The decisions of the courts mentioned above indicate that the application of Section 197 is motivated and justified on the basis of the purposive interpretation of Section 197, namely that Section 197 is intended to protect the continuity of employment of employees whose positions are associated with the business which is being transferred. If this view is correct then the distinction between scenario 1 and scenario 2 would be demonstrably unjust and the distinction between the two scenarios would be arbitrary.

In order to overcome the distinction between the two scenarios, our courts could have reference to the European directives and jurisprudence. This is particularly true as reliance was placed on these sources of law when the LRA was drafted and in the interpretation of Section 197 in the seminal case on Section 197, NEHAWU v University of Cape Town & Others (2003) (CC), in which the Constitutional Court relied on European Courts in interpreting the meaning of the term “going concern”.

Whereas Section 197 is a fairly recent addition to South African employment law, and case law on second generation outsourcing, in particular, is sparse, the United Kingdom has been subject to the Transfer of Undertakings (Protection of Employment) Regulations since the 1980s (Transfer of Undertakings 1981 SI 1981/1794). These regulations are commonly referred to as the TUPE Regulations, and provide an analogue to Section 197, in that they also provide for the automatic transfer of contracts of employment, when a business transfer takes place.

The Transfer of Undertakings (Protection of Employment) (TUPE) Regulations were amended in 2006 (TUPE Regulations 2006 SI 2006/246) to broaden the scope of their application.

As such, TUPE provisions apply, and the contracts of employment of affected employees transfer from the old employer to the new employer, when there is:

▶ a business transfer: this is analogous to the application of Section 197 to the transfer of a business, trade, undertaking or part thereof as a going concern in the case of the sale of a business or sale of assets comprising a business;

▶ a service provisions transfer: this is analogous to the application of Section 197 to outsourcing and second generation outsourcing transactions. However, the service provision transfer includes circumstances where there is a change of a contractor providing services to a client, even if the services were not originally outsourced.

The inclusion of third party contracts under the ambit of a service provision change arguably resolves the ambiguity raised between the hypothetical scenarios 1 and 2 above. Scenario 2 would be subject to the TUPE Regulations 2006, and the new contractor would be substituted in the place of the existing contractor in as far as its employees are concerned.

The TUPE Regulations 2006 are however not open-ended. They focus and narrow their application to a particular set of third party contracts, to ensure that not every single cancellation and transfer of a third party contract would give rise to the service provision transfer consequences. The TUPE Regulations 2006 would only apply if the service provision contract which has been cancelled and awarded to a new party:

▶ was for the provision of services, and not goods; and

involved a defined and organised grouping of employees which was assigned to or concerned with carrying out the services for the client.

For example, the TUPE Regulations 2006 would not apply when a business uses a courier company for the collection and delivery of its parcels and the courier company uses random rather than dedicated employees to collect and deliver parcels. This is because there is no defined or organised grouping of employees and no transfer of employees would take place if the business cancelled the contract and used the services of an alternate courier.

In light of the extended coverage provided for by the TUPE Regulations 2006, and the recognition and application given to these regulations by the UK courts, it may be time for South Africa to consider amending Section 197 to provide clarity on its application. Given that South African courts have recognised the application of Section 197 in outsourcing and second generation outsourcing, an attempt by our courts to curtail the application of Section 197 in such circumstances, without the intervention of the legislature, could result in arbitrary semantic distinctions.

Whether the decision is to extend the application of Section 197 to business transfers and service provision changes, as has been done with the TUPE Regulations 2006, or for these circumstances to be disallowed, Section 197 should be amended to make sure that the intention of the legislature is clearly and unambiguously reflected in the section.
About the Authors

Anastasia Vatalidis
Title: Director
Office: Johannesburg
Direct line: +27 (0)11 535 8472
Fax: +27 (0)11 535 8672
Switchboard: +27 (0)11 535 8000
Email: avatalidis@werksmans.com

Anastasia has been a director and head of Werksmans Attorneys’ Employment practice since 2004. She specialises in pension law, health and safety law and the employment aspects of commercial transactions, including mergers and acquisitions. Her focus is on advising on all employment-related matters including pension fund structuring and organisational restructuring. Anastasia obtained her BA LLB degree at the University of Cape Town and, before joining Werksmans, was a director with a specialised labour law firm. She has also lectured employment law at various tertiary institutions in South Africa.

Bradley Workman-Davies
Title: Director
Office: Johannesburg
Direct line: +27 (0)11 535 8315
Fax: +27 (0)11 535 8615
Switchboard: +27 (0)11 535 8000
Email: bworkman@werksmans.com

Bradley is a director in Werksmans Attorneys’ Employment practice. He specialises in employment law, pension law, and health and safety law, and focuses on commercial employment matters. His knowledge has been honed by combining practical experience with ongoing study. In addition to a BA (Hons) LLB, Bradley has a Higher Diploma in Company Law and a Higher Diploma in Labour Law (both obtained cum laude at the University of the Witwatersrand). He also completed a certificate course in Pension Fund Law at that university. Bradley has published several articles on employment law.