Article

The Application of Section 197 of the Labour Relations Act to Second-generation Outsourcing

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Abstract

Section 197 of the Labour Relations Act 66 of 1995 provides that where an employer transfers the whole or part of a business, trade, undertaking or service to another employer as a going concern, the contract of employment and other obligations are transferred to the new employer. This means that the new employer is substituted for the old employer. In the light of pertinent case law in this regard, it is generally accepted that section 197 also applies to first-generation outsourcing of work. In this case, the employees performing the work or service being outsourced are absorbed by the contracted party, now the new employer. However, uncertainty still prevails as to whether the application of this provision may be extended to a secondary contractor who takes over the outsourced work after the expiry or termination of the first contactor's contract. The question persists whether or not a section 197 transfer occurs when a new contractor is appointed (second-generation outsourcing). If it does apply, how is the longevity of such an application to be determined? With the aid of case law, this article seeks to investigate these questions and the potential imbalance created by the way in which the courts have interpreted the application of this section.

Keywords: section 197 of the LRA; outsourcing; second-generation outsourcing; transfer of business; protection of employees; contract of employment

UNISA university of south africa PRESS

Southern African Public Law
https://upjournals.co.za/index.php/SAPL
Volume 34 | Number 2 | 2019 | #5038 | 19 pages

https://doi.org/10.25159/2522-6800/5038
ISSN 2522-6800 (Online)

Introduction*

Outsourcing is a commercial practice that has been used by many employers in both the private and the public sector. A survey conducted by Norton Rose in 2011 revealed that most businesses that engage in outsourcing cite cost reduction as the most important driver.[1] Other commercial and legal considerations include the reduction of overhead expenses, more especially in the equipment- and technology-dependent services.[2] Outsourcing gives businesses the ability to focus on core business activities and income generation and to allow ancillary functions to be performed by external providers.[3] Another reason cited in favour of outsourcing has to do with quality assurance of the product or service that the business renders, especially if the business does not have the requisite expertise internally.[4]

Another survey conducted by KPMG in 2012 showed that outsourcing is on the rise in the South African labour market.[5] These market trends and the importance of job security for employees employed by external service providers highlight the importance of provisions such as those in section 197 of the Labour Relations Act 66 of 1995 (LRA) and their application to outsourcing transactions. As much as outsourcing transactions may make perfect business sense, they inevitably have a negative impact on the lives of workers.[6] It could be reasonably argued that workers find themselves in an undesirable position when they are rendered redundant to the needs of their employer as a result of a decision to outsource. This is occasioned by a possible reduction in wages and social security benefits or coverage. It is notable that most South African institutions of higher

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* This article is based on a conference paper delivered at the 'Labour Relations Law in South Africa: Twenty Years of Law Making and Adjudication' Conference hosted by the College of Law, University of South Africa on 17 to 18 August 2016.

1 Norton Rose, 'Outsourcing in a Brave New World: An International Survey of Current Outsourcing Practice and Trends' *Report* (2011) 5 <http://ict-industry-reports.com.au/wp-content/uploads/sites/4/2013/05/2012-Outsourcing-In-A-Brave-New-World-Norton-Rose-June-2012.pdf> accessed 8 May 2018.

2 Bin Jiang and Amer Qureshi, 'Research on Outsourcing Results: Current Literature and Future Opportunities' (2006) 44 Management Decision 49.

3 Darshana Sedera and others, 'The Future of Outsourcing in the Asia-Pacific Region: Implications for Research and Practice – Panel Report from PACIS 2014' (2014) 35 Communications of the Association for Information Systems 318.

4 ibid.

5 Edward Webster and Rahmat Omar, 'Work Restructuring in Post-apartheid South Africa' (2003) 30 Work and Occupations 210. See KPMG, '2012 South African Sourcing Pulse Survey (1st & 2nd Quarter)' (2012) <https://home.kpmg.com/za/en/home/insights/2013/08/sourcing-pulse-survey-1st-2nd-quarter-2012.html> accessed 8 May 2018. See also MyBroadBand Staff, 'KPMG Launches First-ever South African 2012 Pulse Survey for Shared Services and Outsourcing' (19 September 2012) <https://companies.mybroadband.co.za/blog/2012/09/19/kpmg-launches-first-ever-south-african-2012-pulse-survey-for-shared-services-and-outsourcing/> accessed 8 May 2018.

6 Webster and Omar (n 5) 198, indicate that more than 20 000 people, mostly black, lost their jobs between 1997 and 2000 as a result of outsourcing, among other reasons.

learning are not spared of this practice, as was evident in the 2016 insourcing protests which were targeted specifically at universities.[7] This article was in part prompted by these protests.

The negative ripple effect of these outsourcing transactions may be exemplified by the operational restructuring that took place at the University of Witwatersrand in the year 2000, when the institution outsourced some of its non-core functions to external service providers.[8] This process led to about 613 employees losing their jobs. Some of these employees were re-employed by the service provider, but they suffered salary cuts and lost some of the employment benefits which they had previously enjoyed.[9] This article is concerned with the application of the law to these transactions and the position in which the law puts employees when these transactions occur. To this end, it deals with transfers of business in terms of section 197 in general, transfers of business in the outsourcing context and the implications of second and further generation outsourcing and lastly, it highlights the different positions taken by the courts in this regard.

Outsourcing as a Transfer of Business or Service

Outsourcing can be defined as a practice or policy of appointing outside consultants to take over the complete function of a particular service or activity of an enterprise which were previously carried out or performed by the business itself.[10] This usually involves non-core activities such as catering, gardening services, security services and cleaning.[11] The courts have described outsourcing as the putting out to tender of certain services for a fee.[12] The contractor performs the outsourced services and in return is paid a fee for its troubles by the employer; such services are usually provided for a fixed period of time.[13] The outsourcing party (or employer) usually reserves the right to either renew the contract with the same service provider or award it to a new contractor or take

7 Universities South Africa (USAf), 'A Guiding Framework for Universities on Reintegrating and/or Managing Currently Outsourced Operations' (2016) 6. See also Lucien Van der Walt and others, 'Globalisation and the Outsourced University in South Africa: The Restructuring of the Support Services in Public Sector Universities in South Africa, 1994–2001' Report for CHET (2002) 12.

8 Dylan Barry, 'Op-Ed: Outsourcing is Fundamentally Wrong' *Daily Maverick* (5 November 2015) <https://www.dailymaverick.co.za/article/2015-11-05-op-ed-outsourcing-is-fundamentally-wrong/#.WvR5KqSFOpo> accessed 8 May 2018. See also Lucien Van der Walt and others, 'Cleaned Out: Outsourcing at Wits University' (2001) 25 South Africa Labour Bulletin 1.

9 Barry (n 8).

10 Milan Kubr (ed), *Management Consulting: A Guide to the Profession* (4edn, Bookwell 2002) 509. See also Jussi Hatonen and Taina Eriksson, '30+ Years of Research and Practice of Outsourcing – Exploring the Past and Anticipating the Future' (2009) 15 Journal of International Management 142.

11 Webster and Omar (n 5) 198.

12 *National Education, Health and Allied Workers' Union v University of Cape Town* [2002] 7 BLLR 803 (LC) ('*NEHAWU v UCT LC*') para 30.

13 ibid.

back the function. This is the reason why the initial outsourcing transaction is usually referred to as first-generation outsourcing.[14]

Section 197 of the LRA deals with the transfer of a business as a going concern and the rights of the employees affected by the transaction. The section provides that when an employer transfers the whole or any part of the business, trade, undertaking or service as a going concern, the new employer is automatically substituted in the place of the old employer in respect of all contracts of employment in existence immediately before the date of the transfer.[15] All rights and responsibilities in terms of those contracts of employment are preserved. One of the benefits of this is that employees' periods of service are not interrupted. If the new employer retrenches some of the employees, their severance pay is calculated to include their period of employment with the previous employer.[16]

The case of *National Union of Metalworkers of South Africa v Success Panel Beater & Services Centre*[17] demonstrates the implications of the application of the provision. In this case, the old employer dismissed an employee before the transfer. The Court, after holding that the dismissal was unfair, ordered the reinstatement of the employee, which had to occur after the transfer of the business. The recent case of *High Rustenburg Estate v NEHAWU*[18] demonstrates even more clearly the consequences of the applicability of section 197 to such a transaction. Before the business was transferred as a going concern, there was an arbitration award against the old employer which was taken on review to the Labour Court. The Labour Court incorrectly set aside the award. The award was upheld by the Labour Appeal Court (LAC*)* on appeal, where the Court reasoned that an arbitration award that binds the old employer immediately before the date of the transfer in respect of the employees to be transferred is also binding on the new employer.[19]

The question whether outsourcing constitutes a transfer of business for the purposes of section 197 came before the 2002 amendments in *NEHAWU v UCT*.[20] In this case, the university decided to outsource its gardening and cleaning staff to external providers. About 267 employees were given notices of retrenchment and invited to apply and compete for a few positions with the service providers, with reduced wages and less

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14 Lynn Biggs, 'The Application of Section 197 of the Labour Relations Act in an Outsourcing Context (Part 2)' (2009) 30 Obiter 666.

15 *The National Education, Health and Allied Workers' Union v University of Cape Town & Others* (2003) 24 *ILJ* 95 (CC) ('*NEHAWU v UCT CC*') para 64.

16 Section 41(2), Basic Conditions of Employment Act 75 of 1997.

17 (1999) 20 *ILJ* 1851 (LC).

18 [2017] ZALAC 20 paras 19–20.

19 ibid.

20 *NEHAWU v UCT LC* (n 12).

favourable conditions of service.[21] The union argued that section 197 applied to the transactions and that the employment contracts (and all their obligations) passed to the new employers (service providers) by operation of law.[22] The Labour Court, *per* Mlambo J, held that section 197 would apply to a transaction only if the old and the new employers agreed that the employees would be transferred together with the business and where the employees in question resist the transfer.[23] According to Mlambo J, the provisions of section 197 did not have an automatic application to transfers of business as a going concern.[24] This was contrary to what the LAC had held in an earlier judgment in *Foodgro v Kiel*[25] where the Court held that section 197 provides for an automatic transfer of contracts of employment.[26] Mlambo J was, however, amenable to the possible application of section 197 to outsourcing transactions in future, given the correct circumstances. But he held that in the present case the outsourcing did not constitute such a transfer and did not trigger section 197.[27]

This matter was taken on appeal to the LAC,[28] where Van Dijkhorst J, who wrote for the majority, held that there must be a consensual transfer of contracts of employment for section 197 to be operational in a transaction.[29] The Court said that the concept of 'business as a going concern' indicated that the legislature intended to allow employers to choose whether or not to transfer employees together with the business.[30] This approach meant that the provision depended on subjective considerations of the two employers rather than objective factors surrounding the transfer.[31] In cases where the business transferor and the business transferee agree that employees are not part of the transfer, the agreement will exclude the operation of section 197 and, according to the Court, that is the end of the enquiry. The Court did not deal with the question whether or not outsourcing transactions constituted a transfer of business for the purposes of section 197. This question was then left undecided at this stage. Zondo JP, as he then was, wrote a minority judgment in which he disagreed with the view of the majority and held that the question whether a business has been transferred as a going concern should be determined objectively and not limited to the subjective intentions of the parties. He noted that if a business can be deemed to be transferred as a going concern even without

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21 Paragraph 10.
22 Paragraph 1.
23 Paragraph 17.
24 Paragraph 19.
25 [1999] 9 BLLR 875 (LAC).
26 Paragraph 25.
27 *NEHAWU v UCT LC* (n 12) para 33.
28 *The National Education, Health and Allied Workers' Union v University of Cape Town & Others* (2002) 23 *ILJ* 306 (LAC) ('*NEHAWU v UCT LAC*').
29 Paragraph 25; Lynn Biggs, 'The Application of Section 197 of the Labour Relations Act in an Outsourcing Context (Part 1)' (2008) 29 Obiter 446.
30 Paragraphs 11 and 21.
31 Biggs (n 29) 448.

its employees, the agreement between the transferor and the transferee to exclude employees in the transfer does not in itself change the fact that the transaction is a transfer of a business as a going concern.[32] Further, Zondo JP held that the purpose of section 197 is to provide protection for employees from job losses when their employers' business changes ownership.[33] The union took the matter on a further and final appeal to the Constitutional Court.

The Constitutional Court[34] adopted a purposive approach when dealing with the question whether the application of section 197 required subjective consensus on the part of the transferor and the transferee or whether the transfer of employees was automatic if section 197 was shown to be applicable.[35] The court held that section 197 should be viewed against the backdrop of early provisions of the chapter that deals with unfair dismissal containing provisions such as section 185 which provides that every employee has a right not to be unfairly dismissed and section 23 of the Constitution of the Republic of South Africa, 1996 (hereafter "the Constitution") which provides that everyone has a right to fair labour practices.[36] The Court observed that section 197 has a dual role in that it does not only facilitate the commercial transfers of business but also to protect workers against job losses. [37] The court further held that a number of factors must be considered in order to determine whether a transfer of business was a 'going concern'.[38] These considerations, which are not exhaustive, include the following:

(i) The transfer or otherwise of assets both tangible and intangible,

(ii) whether or not workers are taken over by the new employer,

(iii) whether or not customers are being transferred, and

(iv) whether or not the same business is being carried out by the new employer.[39]

The Court noted that not a single factor must be considered in isolation and that every matter must be considered on its own merits taking into account the circumstances of the transfer. It was held that section 197 applies automatically to a transfer and has an obligatory effect as long as all the elements are present.[40] The Court decided not to pronounce on the question whether outsourcing constituted a transfer of business for the

32 *NEHAWU v UCT LAC* (n 28) para 65.
33 Paragraphs 64–69.
34 *NEHAWU v UCT CC* (n 15).
35 Paragraphs 16 and 41.
36 Paragraph 43.
37 Paragraph 53; see also Biggs (n 29) 449–450.
38 Paragraph 56.
39 ibid.
40 Paragraph 69.

purposes of section 197.[41] Mlambo J's comments in the Labour Court about this aspect remained instructive.[42]

The Labour Court in *SAMWU v Rand Airport*[43] dealt with a similar case. This matter was decided after the *NEHAWU v UCT* (LAC) judgment but before the Constitutional Court judgment. Rand Airport outsourced its gardening services, which formed part of its maintenance service. The Labour Court was of the view that since the gardening services were only a support function, it could not be 'part of a business' for the purposes of section 197. The Court also held that the outsourcing arrangement was only for a limited period and therefore did not constitute a transfer in terms of section 197. The Court followed the reasoning of the LAC in the *NEHAWU v UCT* case. This decision was appealed successfully at the LAC.

The LAC in *SAMWU v Rand Airport Management Company*[44] espoused the interpretational principles of the Constitutional Court and held that the inclusion of the word 'service' in the provisions of section 197 by the 2002 amendments removed any doubt that an outsourcing contract could fall under section 197. The Labour Court had held earlier that the addition of the word 'service' in section 197 did not extend the scope of its application to outsourcing contracts but merely clarified that a business may consist mainly or only of the rendering of services. According to the Court's reasoning, therefore, non-core functions such as cleaning, gardening and security services formed part of the employer's business that was susceptible to a transfer in terms of section 197. The Court did not have to deal with the question of a 'going concern' but acknowledged that the Constitutional Court in the *NEHAWU v UCT* case had already dealt with the issue and had provided clarity. A takeaway from this judgment was therefore that non-core functions could be part of the employer's business and capable of being transferred as a going concern.[45]

The LAC in *SAMWU v Rand Airport* and the Constitutional Court in the *NEHAWU v UCT* case both sought guidance from international comparative jurisprudence.[46] The courts considered case law from the European Court of Justice, Directives by the European Commission[47] and the British Transfer of Undertakings (Protection of Employment) Regulation[48] to see how the provisions dealing with the effects which a transfer of business has on employment contracts are interpreted in that jurisdiction. This was to be necessary because section 197 owed its origins (and/or the wording is

41 Paragraph 71.
42 *NEHAWU v UCT LC* (n 12) paras 24–33.
43 (2002) 23 *ILJ* 2304 (LC).
44 *SAMWU & Others v Rand Airport Management Company (Pty) Ltd & Others* (2004) 13 (LAC).
45 Biggs (n 14) 665.
46 See *SAMWU v Rand Airport* (n 44) paras 21, 28 and 29 and *NEHAWU v UCT CC* (n 15) paras 47–51.
47 Acquired Rights Directive 77/187 EEC.
48 1981/1794 (TUPE). These regulations were issued in compliance with Directive 77/187 EEC.

similar to) to the directives issued by the Council of the European Communities in 1977. Article 4 of the directive states that the transfer of business should not on its own constitute a valid ground for dismissals or job losses.[49] The Constitutional Court observed that the intention of Regulation 1981/1794 was the protection of employees against unfair dismissals in the case of a transfer of business. The Court could then deduce that, given the similar wording in section 197 and its deliberate location in a chapter dealing with unfair dismissals, the central purpose of the provision is the protection of workers.[50] This was qualified by the observation that section 197 serves a dual purpose: to protect workers against unfair dismissal and to facilitate transfer of businesses.[51] Having considered these judgments, one may be justified in accepting that outsourcing transactions do constitute transfers of business for the purposes of section 197. Having established this, the focus now turns to outsourcing transactions in the secondary generation.

Second-generation Outsourcing

As mentioned above, outsourcing contracts are characterised by not being permanent and the employer has the right to award a given contract, usually after a tendering process, to another service provider in future when the initial outsourcing contract comes to an end.[52] This transition from the initial service provider to a second one gives rise to what is now called a second-generation outsourcing contract.[53] The application enquiry now has to determine whether section 197 is equally applicable to second-generation outsourcing and, by implication, also to future generation outsourcing. The already complicated enquiry is further convoluted by technicalities such as determining the role of each of the three 'employers' who now enter the picture.[54]

The courts and some scholars have highlighted the demerits of the concept of 'second-generation outsourcing'. The Constitutional Court has noted that the concept is artificial and tends to mislead the nature of the enquiry.[55] Wallis opines that the concept of first-generation outsourcing is relevant only if there is second one to follow it and that second-generation outsourcing is nothing of the sort.[56] He adds that second-generation

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49 *NEHAWU v UCT CC* (n 15) para 47. This directive was updated in 2001 through the Council Directive 2001/23/EC of 12 March 2001 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31977L0187> accessed 27 October 2017. See also Biggs (n 29) 432.

50 *NEHAWU v UCT CC* (n 15) paras 50–51.

51 Paragraph 53.

52 Biggs (n 14) 667; see also Craig Bosch, '*Aluta Continua*, or Closing the Generation Gap: Section 197 of the Labour Relations Act and its Application to Outsourcing' (2007) 28 *Obiter* 85.

53 Bosch (n 52).

54 Biggs (n 14) 667–668.

55 *Nehawu v UCT CC* (n 15) para 105. See Malcolm Wallis, 'Is Outsourcing In? An Ongoing Concern' (2006) 27 Industrial LJ 4.

56 Wallis (n 55) 2.

outsourcing simply describes a decision by the main contractor to change its supplier.[57] This concept is, however, used in this article for the sake of differentiating the transactions but also to demonstrate the novel challenge which these transactions pose.

Mlambo J envisaged this difficulty in the *NEHAWU v UCT* case in the Labour Court.[58] He noted that it is difficult to imagine how the outgoing contractor, who has lost the contract through a tender process and has no say in who gets the contract, could transfer his employees to the incoming contractor. Furthermore, the Court could not see how the outsourcing party (main employer) could compel the incoming contractor to take over the employees of the outgoing contractor.[59] Some scholars have expressed a view that the legislature clearly intended to limit the application of section 197 to first-generation outsourcing because it had ample opportunity to indicate explicitly otherwise in the 2002 amendments but decided not to do so.[60] Wallis argues that the legislature did not see fit to alter the wording of the section and it could not be said that it was unaware of the controversy that the provision had caused.[61] He further argues that a new contractor would most likely be a direct competitor of the outgoing contractor and would be reluctant to conclude a section 197(7) agreement, which requires co-operation between the parties.[62] This argument cannot stand scrutiny, however, because the fact that there is resistance on the part of some role-players in the transaction does not mean that it was not the intention of the legislature to bind those parties. In fact, it could be argued that the provision is there precisely to oblige those who resist the application of section 197 to their transaction to be bound by it.[63]

Biggs writes that going along with an interpretation that excludes a second-generation transfer from the ambit of section 197 has negative commercial consequences because it places the prospective contractor in a more favourable position than the outgoing contractor who is also bidding for the contract. This is so because the incoming contractor will not be bound by section 197, which will save them the employment-related costs that the outgoing contractor could not avoid.[64]

Is the Identity of the 'Old Employer' in Second-generation Outsourcing Relevant?

Section 197(1(*b*) requires that a business transfer be carried out by one employer (old employer) to another employer (new employer) to trigger application of the provision.

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57 ibid.
58 *NEHAWU v UCT LC* (n 12).
59 Paragraph 32.
60 Wallis (n 55) 13.
61 ibid.
62 ibid.
63 See Bosch (n 52) 89.
64 Biggs (n 14) 673.

The meaning of the word 'by' has created interpretational problems when it is applied to second-generation outsourcing because in these instances more than two employers are involved. The question that arises is this: Who is the 'old' employer when an outsourcing contract is awarded to a new contractor? Does the use of the word 'by' in the provision require a positive act by the first-generation employer (outgoing contractor)? Furthermore, does the lack of a contractual nexus between the two contractors (first- and second-generation out-sourcees) exclude the transfer from the ambit of section 197?[65] The discussion below examines how the courts have dealt with the issue in selected important decisions.

What the Courts have Said on this Issue

The Labour Court was first called upon to pronounce on this aspect of second-generation outsourcing in *COSAWU v Zikhethele Trade & Another*[66] in 2005. The facts of this case were briefly as follows: Fresh Produce Terminals outsourced its terminal and stevedoring (loading and unloading of ships' cargo) services to a company called Khulisa.[67] This was the initial outsourcing contract. Fresh Produce Terminals later terminated the contract and, after a tendering process, awarded it to a company called Zikhethele Trade.[68] COSAWU, being the representative trade union representing 181 employees of Khulisa, approached the Labour Court for a declaratory order to the effect that section197 applied to the transaction.[69]

The Court adopted a purposive interpretation and said that employees affected by a second-generation outsourcing are as worthy of the legislative protection as those affected by the first.[70] The Court further reasoned that the word 'by' should be read as 'from' in the phrase 'transfer of a business by one employer to another employer' as a going concern.[71] According to the Court's construction, the phrase would read as 'a transfer of a business from one employer to another as a going concern.' This means that the transfer is effective 'from' the client (Fresh Produce Terminals) and not 'by' the outgoing contractor (Khulisa). The Court relied on European Union jurisprudence to formulate a two-phase transfer approach in terms of which the outgoing outsourcee (Khulisa) transferred the business back to the client (Fresh Produce Terminals) and then

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65 See Bosch (n 52) 90, in general, where he discusses the practical problems that the application of s 197 to second-generation outsourcing contracts was envisaged to usher in. He points out that a company tendering for the job would have difficulty in determining an appropriate quotation for doing the job because it now has to consider the existing costs of the labour component and this information might not be provided by the competitor currently performing the function.

66 (2005) 26 *ILJ* 1056 (LC).

67 Paragraph 7.

68 Paragraph 13.

69 Paragraph 1.

70 Paragraph 29.

71 ibid.

the client in turn transferred it to the incoming contractor (Zikhethele).[72] This approach, according to the Court, was to prevent the anomaly where employees transferred as part of the initial outsourcing transfer are protected while those in second and subsequent generations' transactions are not.[73]

This approach was received with both commendation and criticism. Bosch opined that the interpretation of 'by' to mean 'from' was enough to conclude that section 197 was applicable to second-generation outsourcing and that the two-phase transfer approach was not necessary.[74] Besides, the test entailed that the client would become the old employer and the incoming contractor the new employer, and this contradicted the Court's finding that the transfer was between outgoing contractor and incoming contractor. Wallis argues that the Court changed the meaning intended by the legislature which required a positive act on the part of the transferor and that the Court offered no justification for this.[75] It is submitted that it is inconceivable in the real world that an outgoing contractor would be a positive actor in transferring a business to an incoming contractor. These two are business competitors. This function is left at the hands of the client. It is for this reason that this article commends the proactive step taken by the Court in this case. The Court was commended for its attempt to give effect to the constitutional right to fair labour practice, that is, to the purpose of section 197 and the LRA.[76]

The Constitutional Court was later confronted with the same questions in the case of *Aviation Union of South Africa & Another v South African Airways*.[77] The facts were briefly that, in the year 2000, the South African Airways (SAA) outsourced its infrastructure and support services which it deemed to be non-core business.[78] After a tendering process, a company called LGM was awarded a contract to deal with facilities management operations.[79] Among other measures, SAA transferred the employees who performed these functions and relevant assets to LGM.[80] In 2007, SAA decided that it would terminate the contract with LGM with effect from 30 September that year.[81] This was due to the breach of a certain contractual clause by LGM.[82] LGM instituted consultations in terms of section 189(1)–(2) of the LRA with the employees who worked under the contract in contemplation of retrenching them as they were going to be

72 Paragraph 30.
73 Paragraph 29.
74 Bosch (n 52) 88.
75 Wallis (n 55) 10.
76 Bosch (n 52) 87.
77 [2011] ZACC 31 ('*AUSA v SAA CC*').
78 Paragraph 6.
79 Paragraphs 6–7.
80 Paragraph 9.
81 Paragraph 10.
82 ibid.

redundant to its business.[83] The Aviation Union, being the representative trade union of the employees who would be affected by the imminent retrenchments, sought a declaratory order from the Labour Court to the effect that section 197 was applicable to the transaction and that the employees enjoyed protection in terms of the provision.[84] This was after the union had sought assurances from both SAA and LGM that the affected employees would be transferred back to SAA upon termination of the outsourcing contract.[85] SAA was of the view that it had no legal obligation to take the employees back as they were no longer working for it.[86]

The Labour Court adopted a literal interpretation of the wording of section 197 and held that for the provision to be applicable to an outsourcing agreement there must be transfer of business by the old employer to a new one and in the case of second-generation outsourcing such a transfer did not occur.[87] The Court said that in second-generation outsourcing contracts the 'old' employer does not or cannot play the same role of transferring since the business is not in his hands. The Court placed importance on the fact that a transfer should be by the 'old' employer to a 'new' employer and not just from one employer to another.[88] The Court therefore held that, in its view, section 197 did not apply to the termination or second-generation outsourcing.[89]

The union took the matter on appeal to the LAC.[90] The LAC rejected the Labour Court's literal approach to the wording of the provision and instead opted for a purposive approach.[91] The Court said that a literal approach would defeat the very purpose of the provision, which is the protection of employees in the event of a change of business ownership.[92] Furthermore, the Court added that there was nothing in the wording of section 197 that prevented its application to second-generation outsourcing.[93] The Court concluded that section 197 applied to the termination of the contract and by extension to second-generation outsourcing contracts.[94] SAA untiringly took the matter to the Supreme Court of Appeal[95] (SCA), contending that the LAC had erred in its

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83 Paragraph 11.
84 Paragraph 13.
85 Paragraphs 12–13.
86 ibid.
87 Paragraphs 16–17.
88 ibid.
89 Paragraph 19.
90 *Aviation Union of South Africa & Another v South African Airways (Pty) Ltd & Others* 2010 (4) SA 604 (LAC) ('*AUSA v SAA LAC*').
91 Paragraph 56. Davis J notes that even a literal interpretation of s 197 does not preclude its extension to second-generation transfers.
92 Paragraphs 17–18.
93 Paragraph 59.
94 Paragraphs 63 and 65; *AUSA v SAA CC* (n 77) para 22.
95 *South African Airways (Pty) Ltd v Aviation Union of South Africa & Others* 2011 (3) SA 148 (SCA) ('*SAA v AUSA SCA*').

interpretation of the word 'by' to mean 'from' and that the termination constituted a transfer of a going concern as envisaged in section 197.[96] The SCA agreed with the arguments and held that by so doing the LAC had distorted the plain language of the provision.[97] The minority judgment in this Court, however, reached a different conclusion: it held that there was a transfer by the 'old' employer (LGM in this case) to a "new" employer (SAA in this case).[98]

The matter was then taken to the Constitutional Court in an attempt to put an end to the uncertainty demonstrated by the pendulum of decisions by the lower courts. In a split judgment of five to six judges, the Court held that section 197 was applicable to the cancellation of the contract and that it constituted a transfer of business as a going concern as envisaged in the provision.[99]

Jacoob J held with finality that the word 'by' should be given its ordinary meaning.[100] According to the judge, the identity of the 'old' and the 'new' employer depends on the transaction and is not static. The 'old' employer in the first outsourcing contract does not remain the 'old' employer in subsequent successive outsourcing transactions.[101] As a result of this construction, the Court eliminated the problem of having to determine the meaning of the word 'by' in the context of section 197.[102] He added that the questions that should be asked are as follows: Whether the transaction under consideration contemplates a transfer of business by the 'old' employer to the 'new' employer? Whether the transaction creates rights and obligations that require one entity to transfer something in favour or for the benefit of another or to another? If so, do the obligations imposed in a transaction, fairly read, contemplate a transferor who has the obligation to effect a transfer or allow a transfer to happen and a transferee who receives the transfer? If the answer to both these questions is in the affirmative, then the transaction contemplates transfer by the transferor to the transferee. If this transaction is a transfer of a business as a going concern, then section 197 is applicable and the employees are protected.[103] The Court further noted that the application enquiry would be misleading if it focused mainly on the generation of the transfer.[104] By this reasoning, a fifth-generation outsourcing transaction may be covered by section 197 whereas a

96 *AUSA v SAA CC* (n 77) para 24; also paras 31–32, where the Court noted that the word 'by' required a positive action by the business transferor which is not there in second-generation outsourcing.
97 Paragraph 26.
98 Paragraph 27.
99 Paragraph 124.
100 Paragraph 113.
101 Paragraph 103.
102 Paragraph 81.
103 ibid.
104 Paragraph 105.

first-generation transaction may not be.[105] The true enquiry is whether there was a transfer of a business as a going concern by the 'old' employer to the 'new' employer.[106]

The Labour Court was presented with a matter dealing with the application of section 197 to second-generation outsourcing the following year, in *Harsco Metals South Africa v Arcelormittal South Africa Limited.*[107] Harsco Metals South Africa ('Harsco') had six service agreements with Arcelormittal South Africa ('ASA') in terms of which it managed and processed slag, a by-product from the smelting of ore.[108] Harsco had been rendering these services at ASA for about 40 years and its contract was about to expire in March 2011. Prior to this date, ASA instituted a tender process, after which two new contractors were appointed to render the same services.[109] The two new contractors were likely to employ 300 out of 445 Harsco employees and Harsco then approached the Labour Court for a declarator that the transaction was a transfer of business within the ambit of section 197.[110]

In its interpretation of section 197, the Court accepted that the question whether second-generation outsourcing attracted section 197 was already settled by the Constitutional Court in *AUSA v SAA.*[111] The Court noted that the Constitutional Court was clear: the determination on whether an outsourcing contract attracted section 197 was to be determined in a similar manner as any other transfer.[112] Van Niekerk J then dealt with the submission by Arcelormittal which suggested that the *dictum* of Jacoob J in *AUSA v SAA* meant that for a second-generation outsourcing transfer to attract the application of section 197, the first-generation outsourcing transaction must have been a transfer that also fell within the scope of section 197.[113] It was argued, therefore, that the initial outsourcing between ASA and Harsco was simply a contracting out of service and not a transfer of business as contemplated in section 197.[114] The Court disagreed with this assertion and held that Jacoob J was simply saying that the initial outsourcing contract is significant but not determinative.[115] The Court aligned itself with the purposive approach of the LAC in *SAMWU v Rand Airport*,[116] which, according to Van Niekerk J, was consistent with the purpose of section 197 being the protection of employees against dismissals in the event of a change of business ownership and the facilitation of

105 ibid.
106 ibid.
107 (2012) 33 *ILJ* 901 (LC).
108 Paragraphs 7 and 9.
109 Paragraphs 8–9.
110 Paragraph 1.
111 Paragraph 15.
112 Paragraph 15.
113 Paragraphs 16-21 (*dictum* in paras 106–108).
114 Paragraph 18.
115 Paragraph 19.
116 See (n 44).

smooth business transfers.[117] The Court asked and determined three critical questions, which are discussed below. First, it asked whether there had been a transfer. After accepting that some business components and employees of Harsco would be transferred to the new contractors, it concluded that there was indeed a transfer for the purposes of section 197.[118] Secondly, the Court then assessed whether what had been transferred was a business. For this purpose the Court considered comparable jurisprudence of the European Court of Justice on how it applied the EU Directives and the United Kingdom's Regulation of Transfers (TUPE).[119] The Court also considered the reasoning of the LAC in *SAMWU v Rand Airport*,[120] where it was held that the outsourcing of gardening and security services were businesses capable of being transferred in terms of section 197 despite there being no assets, goodwill, employees or resources being transferred.[121] The Court did not have difficulty then in concluding that Harsco was transferring a business for the purposes of section 197.[122] The third consideration was whether the transfer was of a going concern. The Court said that, in order to determine this aspect, a number of factors should be considered. It considered, first, that 300 out of 445 of Harsco's workers would be absorbed by the new contractors.[123] Another consideration was that the new contractors would provide a service to the same sole client (Arcelormittal) and provide a similar service.[124] These factors indicated that there was a continuation of a discrete economic entity, albeit in different hands.[125] Furthermore, the Court considered that assets were to be transferred to the new contractors and it concluded in the end that there was a transfer of a business as a going concern for the purposes of section 197.[126] According to this decision, therefore, it should be concluded that section 197 is applicable to second-generation outsourcing even though the first-generation outsourcing was nothing more than a contracting out of a service outside the parameters of section 197. This is in agreement with the sentiment of Jacoob J in *AUSA v SAA*[127] referred to above that section 197 can be applicable in fifth-generation outsourcing even if it were not applicable in the first one.[128] It is noteworthy that the Court chose not to follow the enquiry laid down by

117 *Harsco Metals* (n 107) para 20.
118 Paragraph 24.
119 Paragraph 26.
120 Note 44.
121 *Harsco Metals* (n 107) para 27.
122 Paragraph 28. This was informed by the fact that Harsco was even transferring about seventy per cent of its employees and considerable assets to the new contractors.
123 Paragraph 33.
124 Paragraph 34.
125 ibid.
126 Paragraphs 36, 37 and 39.
127 *AUSA v SAA CC* (n 77).
128 Paragraph 105.

Jacoob J in *AUSA v SAA*.[129] It is submitted that had the Court followed this approach, the outcome could have been different.

Conclusion

The cases discussed above have shed much-needed clarity on the interpretation of section 197. The ramifications of business transfers can be dire for employees who find themselves in the middle of an outsourcing transaction. Transfers of a business outside the scope of section 197 could mean job losses or new employment with a service provider with lower wages, employment benefits and social security benefits. The courts have adopted a purposive interpretational approach and have given clear guidance that outsourcing transactions constitute a transfer of business and that if such a business is transferred as a going concern, section 197 is automatically attracted to the transaction. Furthermore, the question whether second-generation outsourcing attracts the provision has been dealt with decisively by the Constitutional Court and the Labour Court in *Harsco v Arcelormittal.*[130] The current position is therefore that, depending on the facts surrounding the transfer, section 197 can apply to second-generation outsourcing. This section 197 trigger is not even dependent on the first-generation outsourcing, which could have been a simple contracting out.

This development is welcome in our law as it upholds the protection against unfair dismissals afforded to employees by the LRA. As aptly interpreted by the courts, the provision serves a dual purpose because over and above the protection it extends to workers, it also facilitates business transfers. It is submitted that this protection extends to workers who were not part of the initial outsourcing transfer but who are appointed during the course of the outsourcing contract.

The application of this provision is of practical importance in institutions of higher learning because non-core functions such as cleaning, gardening and security services are still largely outsourced. The provision is definitely not a panacea to the plight of the outsourced workers, but it does provide protection and the comfort that, if properly applied, jobs will be secured when businesses change ownership.

[129] *AUSA v SAA CC* (n 77) para 81.
[130] *Harsco Metals* (n 107).

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