IN THE LABOUR APPEAL COURT OF SOUTH AFRICA, JOHANNEBURG

Reportable

JA79/2014

In the matter between:

MALUTI-A-PHOFUNG LOCAL

MUNICIPALITY **Appellant**

and

RURAL MAINTENANCE (PTY) LTD **First Respondent**

RURAL MAINTENANCE FREE STATE (PTY) LTD **Second Respondent**

Heard: **10 September 2015**

Delivered: **21 October 2015**

Summary: Outsourcing of business – local municipality's manager outsourcing municipality's function of electricity supply – party to agreement undertaking to manage, operate, administer, maintain and expand the municipal electricity distribution network - municipality later cancelling agreement – cancellation of agreement giving rise to transfer of the electricity supply back to municipality – transferor contending that transfer as going concern took place as contemplated in section 197 of the LRA. Labour Court finding that transfer as a going took place – Appeal - municipality contending

lack of authority of the municipal manager to sign agreement and that no transfer of business as a going concern took place – concerning lack of authority, *Oudekraal* principle restated to the effect that until set aside an administrative decision stands. Whether transfer of a business took place - court finding that some components of the business not transferred and withheld by transferor – such components vital for the supply of electricity - municipality not with assets transferred to it able to manage, operate, administer, maintain, expand the municipal electricity distribution network so as to continue the same business run by the transferor – No transfer of business as a going concern took place. Labour Court's judgment set aside- Appeal upheld with costs.

Coram: Davis JA, Coppin JA *et* Savage AJA

JUDGMENT

DAVIS JA

Introduction

[1] Appellant is a local municipality responsible for exercising legislative and governmental functions in the Eastern Free State area, which includes Harrismith, Kestell and Phutaditjhaba. Amongst its functions is the supply of electricity to residents.

[2] It is common cause that in 2011, the then municipal manager of appellant decided to outsource this function to first and second respondents ('Rural'). Rural specialises in assisting municipalities to provide electricity to consumers. It appears that appellant had allowed its electricity infrastructure to fall into a state of disrepair. Major transformers had suffered oil leaks which caused them to malfunction and circuit breakers were damaged beyond repair. There were frequent electricity outages. There were cases of live electricity distribution points which had not been properly secured and which,

if access by members of the public would result in electrocution and potential death. The switchgear was malfunctioning and, at least, in one case a substation exploded killing a person.

[3] It also appeared that appellant could not pay Eskom for the electricity which was supplied. In significant part, this problem was caused by an inability to effectively collect revenue from consumers, because appellant did not have the necessary metering, invoicing and collecting systems in place.

[4] For these reasons, on 3 April 2011, the municipal manager of appellant and Rural concluded the Electricity Management Contract (EMC), in terms of which, Rural was appointed by appellant to manage, operate, administer, maintain and expand the municipal electricity distribution network for a period of 25 years, after which the obligation to supply electricity to residents would revert back to appellant. The EMC was signed on behalf of the appellant by the former municipal manager, Mr LM Mtombela and by Mr Ilze Bosch on behalf of Rural.

[5] It is also common cause that, in terms this agreement, Rural accepted 16 employees from appellant by way of a transfer agreed to by the parties which transfer was governed by s197 of the Labour Relations Act of 1995 ('LRA').

[6] Rural commenced the performance of its obligations under the EMC from 1 September 2011. It incurred significant expenditure in expanding the business and it enlarged the workforce to 127 employees. It invested money in this expansion process which it explained in its founding affidavit as follows:

> 'Rural has incurred considerable expenditure in respect of:
>
> 1. the purchase of network materials being switch gears, polls, transformers, mini-substations and prepaid meters and the purchase of 17 new light commercial vehicles, totalling R13,523,766.51;

2. the purchase of two specialised trucks beings an Iveco 4x4 live line truck and an Iveco 6x6 drill rig totalling R7,500,00;

3. electrical infrastructure mapping (ie. the compiling and recordal of the details of the Municipality's electrical distributions infrastructure), the mapping of townships within the geographical area of the Municipality, the purchase of software systems in regard to the electricity metering, billing, collection, customer case, fault desk, call centre, technical services and the like.. salaries, legal costs, travel costs, technical investigations, financial investigations and feasibility study costs totalling R 69,987,804; and

4. the purchase of an immovable property in Harrismith to be used to construct offices for Rural's employees and staff accommodation. The total costs of the immovable property including construction will be approximately R 5,000,000.'

[7] On 5 August 2013, appellant advised Rural that it considered that it was not bound by the terms of the EMC, because its former municipal manager, Mr Mtombela, had not obtained the requisite authority from appellant to enter into the contract on behalf of the appellant. Therefore, his action was *ultra vires* and, accordingly, the contract was null and void. A further reason emerged as a basis for this contention, namely that Rural had not procured the necessary license from the relevant regulator NERSA, which is a mandatory requirement in terms of the Electricity Regulations Act 4 of 2006.

[8] Rural contends that appellant had no right to resile from the EMC and that its actions amounted to a breach of contract. Accordingly, it has sought to cancel the contract. This contractual dispute is the subject of a pending action in the Free State High Court. It appears that the action was set down for hearing in October 2014 but the matter was postponed and will be heard later this year.

[9] Notwithstanding this pending action, Rural delivered an information pack to appellant on 3 October 2014 containing a list of the names of the 127 affected

employees, their employment contracts, an organogram of Rural's organisational structure together with a proposed agreement in terms of s197 of the LRA. Rural then sought to transfer the 127 employees onto appellant's payroll. It returned to appellant what it termed "possession of the Network and the Capital Assets"; in other words the electricity distribution infrastructure which consisted largely of the properties, tools equipment and vehicles that had been transferred by appellant to Rural in the first place.

[10] In its replying affidavit, Rural said, "the retention by Rural of peripheral assets such as vehicles, computer stations and the like does not affect this conclusion"; that is it had transferred sufficient of the infrastructure to trigger the operation s197 of the LRA.

[11] The relevant portion of s197 reads as follows:

> '1. In this section:
>
> (a) "business" includes the whole or a part of any business, trade, undertaking or service; and
>
> (b) "transfer" means the transfer of a business by one employer ('the old employer') to another employer ('the new employer') as a going concern.
>
> 2. If a transfer of a business takes place, unless otherwise agreed in terms of subsection (6):
>
> (a) 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 transfer;
>
> (b) All the rights and obligations between the old employer and an employee at the time of transfer continue in force as if they had been rights and obligations between the new employer and the employee;

(c) Anything done before the transfer by or in relation to the old employer, including the dismissal of an employee or the commission of an unfair labour practice or active unfair discrimination, is considered to have been done by or in relation to the new employer; and

(d) the transfer does not interrupt an employee's continuity of employment, and the employer's contract of employment continues with the new employer as if with the employer.'

[12] The court *a quo* found that it was satisfied that the business of providing a service to the local inhabitants, had previously been in the hands of Rural but had now been transferred to appellant. It thus concluded that there has been a transfer of a business as a going concern as contemplated in s197. Accordingly, Tlhotlhalemaje AJ ordered that, with effect from 1 April 2014, the employment contracts of all 127 affected employees were to be transferred to appellant in terms of s197 (2) of the LRA.

[13] On petition, this issue has now come on appeal to this Court.

The key issues

[14] Mr Redding, who appeared together with Mr Hopkins and Ms Freese on behalf of the appellant, raised an initial point to the effect that, even if factually there had been a transfer of business "as a going concern", the court *a quo* had erred in finding that, as a matter of law, a transfer had taken place. In his view, there could be no transfer unless there was some positive action on the part of the transferor. The transferor would have to engage in a deliberate and intentional "handing over" of the business. Section 197 employs the words of a business being transferred "by one employer (the old employer) to another employer (the new employer) as a going concern." In Mr Redding's view, this connotes a positive act to effect the necessary transfer.

[15] The wording of this section has been the subject of a great deal of debate, both among academic commentators and in case law. See, in particular, Malcolm Wallis “It's Not Bye-Bye to 'By': Some Reflections on Section 197 of the LRA” 2013 (34) *Industrial Law Journal* 779-807 and the authorities cited therein together with the decision of the Constitutional Court in *Aviation Union of South Africa and Another v South African Airways (Pty) Ltd and Others* 2012 (1) SA 321 (CC). In reviewing the judgment of the Constitutional Court, Wallis, writing in his academic capacity, concludes as follows:

> ‘Whilst the principal is the agency by which that occurs, the principal is not the employer of the affected workers and that employer (the old employer for the purposes of s 197) has not effected any transfer. All that they can do is withdraw from the scene. In those circumstances the position remains that the transfer has to been transfer by the old employer. The principal is the party that causes the transfer of the business not the old employer. The judgment of the CC not only does not alter that, it reinforces it. That conclusion should not be obscured by the outcome of the litigation, which was driven by the peculiar facts of that case.’[1]

[16] Following upon this approach, Mr Redding submitted that, unless Rural took positive steps to cause its business to be transferred back to appellant, s197 of the LRA could not have been triggered in this case. In particular, Mr Redding submitted that the appellant had taken the view that the EMC had been concluded *ultra vires* and, accordingly, the contract was void *ab initio*. It therefore followed that no positive act as envisaged in s197 had taken place to cause the business to be transferred back to the appellant.

[17] Regrettably, this argument does not take sufficient cognisance of the implications of the decision in *Oudekraal Estates (Pty) Ltd v City of Cape Town and Others*[2] where the following was said:

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[1] At 797.
[2] 2004 (6) SA 222 (SCA).

> 'For those reasons it is clear, in our view, that the Administrator's permission was unlawful and invalid at the outset.…But the question that arises is what consequences follow from the conclusion that the Administrator acted unlawfully. Is the permission that was granted by the Administrator simply to be disregarded as if it had never existed? In other words, was the Cape Metropolitan Council entitled to disregard the Administrator's approval and all its consequences merely because it believed that they were invalid provided that its belief was correct? In our view, it was not. Until the Administrator's approval (and thus also the consequences of the approval) is set aside by a court in proceedings for judicial review it exists in fact and it has legal consequences that cannot simply be overlooked. The proper functioning of a modern State would be considerably compromised if all administrative acts could be given effect to or ignored depending upon the view the subject takes of the validity of the act in question.'[3]

[18] This approach has been further developed in *MEC for Health EC v Kirland Investments (Kirland)*[4] where Cameron J said:

> 'The fundamental notion – that official conduct that is vulnerable to challenge may have legal consequences and may not be ignored until properly set aside – springs deeply from the rule of law. The courts alone, and not public officials, are the arbiters of legality.'[5] [Footnote omitted]

[19] In *Kirland* an acting superintendent general in the Department of Health Eastern Cape granted approval for the establishment of private hospitals, which permission initially had been refused by the superintendent general before he took an extended period of sick leave. When he resumed duty, the superintendent general withdrew the approvals on the grounds that the acting superintendent general had acted improperly and hence the former could withdraw the decision.

[3] At para 26.
[4] 2014 (3) SA 481 (CC).
[5] At para 103.

[20] The respondent approached the High Court seeking an order overturning the decision to withdraw the purported approval and thus reinstating the initial approval that had been granted by the acting superintendent general.

[21] Of relevance to the present dispute, the High Court held that the withdrawal of the approval should be overturned on the basis that when the decision to withdraw the approvals was taken, the superintendent general had not complied with the requirements of procedural fairness. On appeal to the Constitutional Court, the wider question of the implications of the *Oudekraal* decision were examined.

[22] For the majority, Cameron J found that the appeal had to fail because:

> 'The approval communicated to Kirland was therefore, despite its vulnerability to challenge, a decision taken by the incumbent of the office empowered to take it, and remained effectual until properly set aside. It could not be ignored or withdrawn by internal administrative fiat. This approach does not insulate unconstitutional administrative action from scrutiny. It merely requires government to set about undoing it in the proper way. That is still open to government.'[6]

[23] This finding is clearly applicable to the present set of facts. It is not sufficient, as Mr Redding argued, that, as the appellant has taken steps in another court to declare the contract *ultra vires* and consequently void, the *Oudekraal* principle does not apply thereto. See also *Nature's Choice Properties (Alrode) (Pty) Ltd v Ekurhuleni Metropolitan Municipality* 2010 (3) SA 581 (SCA); Hoexter *Administrative Law in South Africa* 2nd ed (Juta 2012) at 546 – 550. Accordingly, in the absence of a finding by the Free State High Court, it cannot be said that the EMC can be ignored legally and there could be no transfer of the business "by" Rural to the appellant because the return of the infrastructure happened in consequence of a *restituo in integrum,* and not as a result of some positive conduct on the part of the relevant parties.

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[6] *Kirland* at para 105.

Has there been a transfer as a going concern?

[24] Mr Redding submitted that to classify the transaction as a going concern, what must be transferred is "the same business in different hands". The business that was operated before the transfer must be substantially the same as the business that is capable of being operated after the transfer. Accordingly, a business cannot be sold as a going concern if it cannot seamlessly commence trading in substantially the same way as the business was traded previously. Mr Redding submitted that the business that was operated by Rural immediately before the handover used specialised tools and assets in a manner that the appellant could not employ after "the hand over", because these same tools and assets had not been handed over by Rural. Significant assets were not transferred to the appellant, including:

1. A host vending system, software and intellectual property relating to pre-paid metering;

2. An immovable property in Harrismith which provided offices and accommodation for at least 18 of the 127 employees;

3. Computer software systems for electricity metering, billing, collection, customer care, fault desk, call centre, technical services;

4. Computer hardware and stationery;

5. Two specialised trucks (Iveco 4x4 Live Line truck and Iveco 6x6 drill rig) and 17 new light commercial vehicles; and

6. Electrical infrastructure mapping.

[25] Mr Redding submitted that what Rural had handed over was the basic infrastructure needed to supply electricity. It had transferred a service to the appellant but had not transferred the actual business that provided the comprehensive service which it had conducted prior thereto. When appellant decided to outsource the business to Rural, it had done so on the basis of two

important considerations; that is the inadequate maintenance of the infrastructure and the appellant's inability to properly bill consumers and collect revenue.

[26] While accepting that the basic infrastructure have been handed back to appellant, this was insufficient to operate the trading business. More was required to convert the mere supply of electricity into a viable trading business. The additional components, which were required to perform this additional set of activities, were never transferred to appellant and accordingly the same business was not transferred. Thus, it could not be concluded that appellant had received "a going concern" from Rural, without a substantial additional financial investment which had to be made in order to replicate the business that Rural had run prior to the handover.

[27] Mr Pretorius, who appeared together with Mr Hollander on behalf of the respondent, submitted that an extensive electricity transmission and distribution network comprising all the equipment, wires and hardware installed in order to receive the bulk electricity from the Eskom metering, point and to distribute electricity to the end-users through the end-user metering point, had been transferred back to the appellant. This included substations, switchgear protection and isolators, transformers, power lines, dropout fuses and links and metering equipment together with the appellant's prepaid vending system, comprising approximately of 30 prepaid stations.

[28] In support of his submission that it was sufficient for the entire operating infrastructure and capital assets to be transferred to appellant in order to trigger the application of s197 of the LRA, Mr Pretorius referred to the test as formulated in *Spijkers v Gebroerders Benedik Abattoir v Alfred Benedik en Zonen:*[7]

> The decisive criterion for establishing whether there is a transfer for the purposes for the directive is whether the business in question retains its

[7] [1986] 2 CMLR 296 (ECJ).

> identity. Consequently a transfer of an undertaking, business or part of business does not occur merely because its assets are disposed of. Instead it is necessary to consider… whether the business was disposed of as a going concern, as would be indicated, inter alia by the fact that its operation was actually continued or resumed by the new employer, with the same or similar activities. In order to determine whether those conditions are met, it is necessary to consider all the facts characterising the transaction in question, including the type of undertaking or business, whether or not the business's tangible assets, such as buildings and movable property, are transferred, the value of its intangible assets at the time of transfer, whether or not the majority of its employees are taken over by the new employer, whether or not its customers are transferred and the degree of similarity between the activities carried on before and after the transfer and the period, if any, for which those activities were suspended. It should be noted, however, that all those circumstances are merely single factors in the overall assessment which must be made and cannot therefore be considered in isolation.'[8]

[29] On the basis of this *dictum*, Mr Pretorius submitted that it was clear that the same business was conducted in the same location for the benefit of the same constituency, albeit in different hands. There had been a transfer of the infrastructure and capital infrastructural assets which was sufficient to conclude that the business which was now conducted by the appellant was the same business as had been conducted by the respondents. See also *Harsco Metals SA (Pty) Ltd v Arcerlomittal SA Ltd* [2012] 4 BLLR 385 (LC) at para 34 – 36.

[30] In the debate about the appropriate test, Mr Redding sought to rely on a decision of the European Court of Justice in *Oy Liikenne Ab v Pekka Liskojärvi, Pentti Juntunen* (*Oy Liikenne)*[9]. In this case the court noted that when a transfer is of a going concern, the transfer must relate,

[8] At para 11-13.
[9] [2001] IRLR 171 ECJ.

> 'to a stable economic entity whose activity is not limited to performing one specific work's contract… the term "entity" thus refers to an organised grouping of persons and assets facilitating the exercise or an economic activity which pursues a specific objective.'[10]

The court went on to say

> 'So the mere fact that the service provider by the old and new contractors are similar does not justify the conclusion that there has been a transfer of an economic activity between the two undertakings. Such an entity cannot be reduced to the activity entrusted to it. Its identity also emerges from other factors such as its workforce, its management staff, the way in which its work is organised its operating methods, or indeed, where appropriate, the operational resources available to it.'[11]

[31] In this case, the court dealt with the transfer of seven local bus routes from the respondent to the appellant. It noted:

> 'In a sector such as scheduled public transport by bus, where the tangible assets contribute significantly to the performance of the activity, the absence of a transfer to a significant extent from the old to the new contractor of such assets, which are necessary for the proper functioning of the entity, must lead to the conclusion that the entity does not retain its identity.'[12] Para 42

Evaluation

[32] To the argument that the case of *Oy Liikenne* is authority for the proposition that in an asset intensive industry such as the delivery of petroleum products by a tanker, the absence of a transfer of such assets or a significant part of them is decisive, in that in these circumstances the entity does not retain its

[10] At para 31.
[11] At para 34.
[12] At para 42.

identity, the Court of Appeal in *P and O Trans-European Limited v Initial Transport Services Limited*[13] said:

> 'to determine whether the conditions for the transfer of an economic entity are satisfied, it is also necessary to consider all the factual circumstances characterising the transaction in question, including in particular the type of undertaking or business involved, whether or not its tangible assets such as buildings and movable property are transferred, the value of its intangible assets at the time of the transfer, whetehr or not the core of its employees are taken over by the new employer, whether or not its customers are transferred, the degree of similarity between the activities carried on before and after the transfer, and the period, if any, for which those activities were suspended. These are, however, merely single factors in the overall assessment which must be made, and cannot therefore be considered in isolation (see in particular *Spijkers* paragraph 13 and *Süzen* paragraph 14).'[14] See also Wynn-Evans *The Law of TUPE Transfers* (Oxford University Press 2013) at 41-44.

[33] It is clear therefore that the overall assessment depends on an examination of the totality of the business; in this case, the business operated by Rural prior to the transfer.

[34] The court *a quo* held that the vehicles, drill, rigs, tools, computers, software, metering and billing systems, intellectual property, debtors' information and debtors books were peripheral assets used in the conduct of the business. The contrary argument was that this focused the attention of the enquiry solely on a service that supplies electricity, rather than upon the totality of the service which had been performed by Rural and which could be described as its business. Following this description, the business conducted by Rural operated on two legs, namely the provision of adequate infrastructure in order for residents to be supplied with electricity and the mechanism by which to generate sufficient revenue for the supply of electricity by way of an adequate

[13] [2003] IRLR 128 (CA).
[14] At para 12 quoted in *Oy Liikenne* at para 33.

billing of consumers and the collection of what was owed for the supply of electricity.

[35] In its founding affidavit, deposed to by Mr Bester, Rural states as follows:

> 'The entire Network Business relating to all aspects of the Project, i.e. the provision of all electricity related services to inhabitant of the Municipality's jurisdictional area, has reverted back to and has been taken over by the Municipality and is already under the control of the Municipality and possession of the Network and the Capital Assets have already been returned to the Municipality.
>
> The entire electricity distribution infrastructure of the Municipality that Rural and Rural Free State were in control of and utilised (and maintained and upgraded) for the provision of all electricity related services to inhabitants of the Municipality's jurisdictional area, as the Municipality had previously done, are no longer under the control of Rural and Rural Free State and has been handed back, together with the additions and improvements thereto effected by Rural and Rural Free State, to the Municipality.'

[36] Significantly, earlier in his affidavit Mr Bester sets out "the considerable expenditure" incurred by Rural, when it began to fulfil its obligations under the EMC including two specialised trucks, electrical infrastructure mapping and the purchase of an immovable property as well as software systems 'in regard to the electricity metering, billing, collection, customer care, fault desk, call centre, technical services and the like'. All of these were considered to be necessary for the operation of the business conducted by Rural. As indicated earlier, many of these assets were not transferred to the appellant and accordingly, without significant investment by the latter, it would be impossible for the appellant without more, to seamlessly conduct the same business as that which had been conducted by Rural.

[37] In my view, given that the *onus* rests upon the respondent to show, on the probabilities, that a transfer of a business as a going concern had taken

place, it cannot be said that the same business conducted by Rural had been transferred so that it was now conducted by a different entity, namely appellant. Take but one critical issue, debt collection. For debt collection to be continued seamlessly by appellant, this component of the business had been conducted by Rural, it was necessary to meter the use of electricity, invoice the consumer and collect payments therefrom. Essential to this process would have been the use of software and information stored and used in digital form as had been employed by Rural. In short, the means to perform this debt collection activity had not been transferred. On its own, this was a significant component of the overall business. It supports the overall assessment that it cannot be said, on these papers, that the very business conducted by Rural had been transferred to appellant. Expressed differently, appellant would not have been able to continue business seamlessly after the "transfer". For these reasons, the appeal must be upheld.

Order

[38] The appeal succeeds with costs, including the costs of two counsel. The order of the of the court *a quo* is set aside and replaced with the following:

The application is dismissed with costs.

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Davis JA

Coppin JA and Savage AJA concur in the Judgment of Davis JA.

APPEARANCES:

FOR THE APPELLANT:	Adv AIS Redding SC, Adv K Hopkins and Adv S Freese Instructed by Majavu Inc
FOR THE RESPONDENTS:	Adv PJ Pretorius SC and Adv L Hollander Instructed by Webber Wentzel