Protection of employees in the event of the insolvency of their employer: a comparative study of South Africa and the European Union

by

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A dissertation submitted in partial fulfilment of the requirements for the degree of Master of Laws in the Faculty of Law, Mafeking Campus, of the North-West University.

Supervisor Prof MLM Mbao

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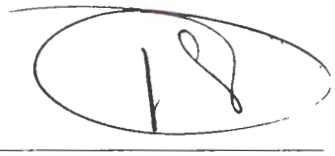
Candidate's Declaration

I declare that this dissertation for the degree of Master of Laws at North-West University, Mafeking Campus, hereby submitted, has not previously been submitted by me for a degree at this or other University, that it is my own work in design and execution and that all materials contained herein has been duly acknowledged.



RABOLALA SHADRACK MOKOBANE

Statutory Declaration

I, Professor Melvin L M Mbao, hereby declare that this dissertation by Rabolala Shadrack Mokobane for the Degree of Master of Laws (LLM) be accepted for examination.

Professor M.L.M. Mbao

Abstract

This study is concerned with protection of the rights of employees in the event of insolvency of their employer. The investigation has been prompted by the coming into operation of the new Labour Relations Act 66 of 1995. the inclusion of the labour rights in the Constitution of the Republic of South Africa, Act 108 of 1996 and the amendments to the Insolvency Act 24 of 1936. The aim is to investigate as to what extent these legislative measures protect the labour rights of employees in the event of the insolvency of their employer. The provisions of company law affecting the employments rights of employees have been discussed as well. For the purposes of comparison the position at International level and in the European Union has been discussed.

Previously the insolvency of the employer automatically terminated contracts of employment of employees. Termination of contracts of employment was treated as being brought about by operation of law for which nobody could be blamed. Employees had no right of action against the insolvent employer except to lodge their claims against his insolvent estate. In the case where the insolvent undertaking was sold and transferred as a going concern, the new employer was not bound to take them over. He could take them over if he so wished but on terms and conditions dictated by him.

In terms of the new Labour Relations Act, the new employer is now bound to take them over. Where there is a doubt as to whether a particular sale of an undertaking or part thereof constitutes a transfer the courts resort to the provisions of the Constitution to come to the rescue of the employees.

The problem with the new dispensation is that the accrued rights of employees such as arrears of pay, payment in respect of leave or holidays and severance pay are not transferred together with contracts of employment to the new employer. The employees are expected to lodge their claims against the insolvent estate of the insolvent employer which might not have anything after the claims of the secured creditors have been met. The same position obtains in the European Union when an insolvent undertaking is transferred but in the European Union the claims of employees are protected by way of institutions guaranteeing payments of claims of the employees in the event of insolvency of their employer. In the case where an insolvent employer fails to meet the

claims of the employees the guarantee institutions pay them. There are no such institutions in South Africa.

There are ways in which an insolvent company could be saved from being liquidated and employees jobs saved. This could be done by placing a company under judicial management or by compromise or arrangement. These mechanisms in terms of which the company may be rescued from being liquidated have been reported to be a total failure. They are outdated and not in touch with the new developments in the world of business.

My conclusion is that the present protections of the labour rights of the employees are inadequate, companies are still being liquidated on a large scale and employees are still losing a lot when it comes to arrears of salaries and severance pay.

It is recommended that guarantee institutions be established to guarantee the unpaid claims of the employees. The rescue methods should in the corporate world be reformed to be in line with the present day realities and trends elsewhere, especially those in the European Union.

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(1) Atlantis Diesel Engines (Pty) Ltd v National Union of Metal Workers (1994) 18 Industrial Law Journal 1274

(2) Clothing and Textile Workers Union and others v Waverly Blankets Ltd (1999) 20 Industrial Law Journal 2744 (CCMA)

(3) Hoffmann v South African Air Ways 2001 (1) SA 1 (CC)

(4) Intercompany Security Services (Cape) (Pty) Ltd v General Workers Union (1995) Industrial Law Journal 854 (LAC)

(5) Kauesa v Minister of Home Affairs and others 1995 (11) BCLR 1540 NHS

(6) Minister of Health v Treatment Action Campaign 1996 (4) SA 744 (CC)

(7) National Education Health and Allied Workers Union v University of Cape Town 2003 3) SA 1

(8) National Union of Metal Workers SA v Atlantis Diesel Engines (Pty) Ltd (1993) 14 Industrial Law Journal 642

(9) National Union of Metalworkers of SA v Bader Bop (Pty) Ltd and Others, (2003) 20 Industrial Law Journal 305 (CC)

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(14) SA Agricultural Plantation and Allied Workers Union v HL Hall and Sons Group Services Ltd and Others (1999) 20 Industrial Law Journal 399 (LC)

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Germany

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United Kingdom

Transfer of Undertakings Protection of Employment Regulations 2006

Transfer of Undertakings Protection of Employment Regulations 1981

ILO Conventions

Convention 173 of 1992

Convention 87 of 1948

European Union Directives

Directive 77/187/EEC as amended by Directive 98/50 and Consolidated in Directive 2001/23/EC

Directive 80/987/EEC

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Firstly I would like to thank my present supervisor, Professor Mbao, who despite his other commitments at the University took upon his shoulders to supervise me in this study, when suddenly things came to a halt and news broke that my previous supervisor would no longer be available to take me further to the completion of this study. The news that my previous supervisor would no longer be available to assist me was a last blow on me and I was on the brink of abandoning this study despite the fact that it has used up a great deal of my precious time, health and money in its course. I sincerely thank the University, in particular the Faculty of Law and Professor Mbao for having extended a helping hand to me when I had no one to look to.

Secondly I would like to thank Professor Marius Olivier for having supplied me with the reading materials during the course of my study for this degree. These materials have been the source of guidance to me and gave direction in doing my own research.

Thirdly I would like to thank my wife Nomhle Mokobane and my children Neo and Mogomotsi who always stood by me and encouraged me not to give up in this trying time.

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Lastly I would like to thank the Almighty God for having protected, guided and blessed me with all that I have so far and hope for more blessings in future.

Dedication

This dissertation is dedicated to my children Neo and Mogomotsi Mokobane

CHAPTER ONE: INTRODUCTION

1.0 Background

This chapter deals with the introductory part of this work and is aimed at serving as a synopsis of the dissertation. The dissertation is concerned with the protection of employees in the event of the insolvency of their employer.

The dissertation is centered on the South African law in this respect but the position of the law in other jurisdictions, in particular the European Union and International law will be considered for the purposes of comparative perspectives and with a view to drawing on the experience of these countries.

1.1 Statement of the problem

This dissertation is aimed at examining the current protections of employees in the event of insolvency of their employers. An employer in the context of this study includes a registered company and a close corporation. In the past the Government in this country paid little attention to the protection of employees in the event of insolvency of their employers. employees were treated just like any other creditors. Insolvency law was regulated under the old section 38 of the Insolvency Act. 24 of 1936.

Section 38 has since been amended and substituted by a new section 38. Prior to its amendment, section 38 of the Insolvency Act. 24 of 1936 terminated contracts of employment of employees upon sequestration or liquidation of an employer. Section 38 operated also in the case of a company and a close corporation unable to pay its debts.[1] The effect of termination of contracts of employment of the employees was that employees became creditors of an insolvent employer and were therefore not entitled to consultation and information as employees of an insolvent employer.[2] There was also no specific legal provision in the Act dealing with the interest of the employees when the business was to be transferred to a new employer.

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[1] Olivier, M. P. and Potgieter, O.: "The Legal Regulation of Employment Claims in Insolvency and Rescue Proceedings: A Comparative Inquiry". 1995 ILJ Volume 16 Part 6 p. 1318 – 1319

[2] Blackman, M.; "The Employee and Insolvent Company" 1993 ILJ Volume 14 pg 561, also Olivier and Potgieter Ibid. no. 1 p. 1325 – 1326

The courts were also reluctant to deal with the issue in the absence of a specific provision in the law to that effect[3]. This state of affairs left employees unemployed and with minimal claims against the insolvent estate of an employer. In the new labour dispensation, attempts have been made to improve employees' plight in this situation, with the enactment of the Labour Relations Act 66 of 1995. However, this in turn has led to a number of interpretational problems surrounding employment contracts that were meant to be transferred together with the business that was sold or transferred as a going concern.[4]

The problem was occasioned by the fact that Section 38 of the Insolvency Act terminated contracts of employment of the employees upon sequestration or liquidation of an employer while section 197 of the Labour Relations Act 66 of 1995 provided for the automatic transfer of contracts of employment when the business of the employer was to be sold or transferred as a going concern. Different decisions prevailed as to the correct interpretation of these provisions. In the case of SA Agricultural Plantation and Allied Workers Union v HL Hall and Sons Group Services and Others,[5] the Labour Court was called upon to consider the effect of liquidation of a company on the contracts of employment with its employees. Landman J, considered the provisions of section 210 of the Labour Relations Act, which provide that if the provisions of any other law (other than the Constitution) conflict with the provision of the Labour Relations Act, the provision of LRA will prevail. After having considered the provisions of this section he found that since the Labour Relations Act was silent on the termination of contracts of employment upon the insolvency of the employer, there was no conflict between the Labour Relations Act and the Insolvency Act. Accordingly, the court held that the liquidation of the company concerned would *ipso jure* result in the termination of the contracts of employment between the company and its employees by virtue of the provisions of section 38 of the Insolvency Act. In addition the court stated that "the reach of the Labour Relations Act 1995 halts once insolvency enters the picture and that the law of insolvency, administered in this instance by the High Court, takes over".[6] The other problem was whether the automatic termination of contracts of

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[3] Jordaan, B.; "Transfer Closure and Insolvency of Undertakings" 1991 ILJ Volume 12 Part 5, 939
[4] Olivier and Potgieter; Ibid. no. 1 at p.1331
[5] 1999 20 ILJ 399 (LC)
[6] SA Agricultural Plantation and Allied Workers Union v H L Hall and Sons Group Services and Others Ibid no. 5 at p. 404 para 22

employment in terms of section 38 of the Insolvency Act 24 of 1936 constituted dismissal as contemplated in section 186 of the Labour Relations Act, 66 of 1995.[7]
This problem was considered in the case of National Union of Leather Workers v Barnard and Perry NNO.[8] In this case a company was wound up as a voluntary winding up by the creditors. In the judgment of the court aquo the court found that the termination of contracts of employment in question did not constitute dismissal as contemplated in section 186(a) of the Labour Relations Act.

It was held that it was not the decision of the employer to institute the proceedings which terminated the contracts of employment and it could consequently not be brought within the ambit of section 186(a) of the Labour Relations Act. On appeal, the Labour Appeal Court ruled that the termination of the employees' contracts of employment constituted dismissal as contemplated in section 186(a) as read with section 213 of the Labour Relations Act. The reason given was that the decision to place the company in voluntary winding up was one taken entirely by the shareholders and this had the effect that the employer in effect directed the process. Different considerations would apply if the company was placed under compulsory winding up by the court; in that case it could not be said that it was the act of the employer which directed the process. In the case of Ndima and Other v Waverly Blankets: Sithukuza and Others v Waverly Blankets Ltd [9] Zondo J. had the opportunity to consider the interplay between section 38 of the Insolvency Act and section 197 of the Labour Relations Act. In this instance the interaction between the sections took place against the background of a company that was provisionally liquidated and where a scheme of arrangement was entered into. With reference to the case of SA Agricultural Plantation and Allied Workers Union v H L Hall and Sons Group Services and others.[10] the court disagreed with the reasoning that the Labour Court had no jurisdiction to entertain the applicants' claims because they fell with the scope of insolvency law that was administered by the High Court and further the fact that the provisions of the Labour Relations Act come to a halt once insolvency law entered the arena.

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[7] van Eck, B.P.S. and Boraine, A.; "Voluntary Winding up of a Company and "Dismissals" in terms of the Labour Relations Act", 2002 (65) THRHR 613 – 617.
[8] 2001 (4) SA 1261 (LAC)
[9] 1999, 20 ILJ156 (LC)
[10] SA Agricultural Plantation and Allied Workers Union v H L Hall and Sons Group Services and Others Ibid no. 5

It held that, that part of the decision did not form the ratio decidendi of the judgment. Zondo, J, stated that the real issue in dispute was the interpretation of the words "when a business is transferred" which appeared in the previous section 197 (2) (b) of the Labour Relations Act. Although reluctant to do so, he held that a transfer of shares as part of a scheme of arrangement did not amount to a transfer of a business as a going concern as contemplated in section 197 of the Labour Relations Act and that the employees were not protected under these circumstances. He concluded that there was a crying need for an amendment of labour legislation and section 38 of the Insolvency Act. An option proposed by the court was that legislation be amended to provide that contracts of employment were suspended on provisional liquidation and only terminated on final liquidation.

In order to solve this problem and related issues the following Acts were amended: The Insolvency Act 1936[11], Labour Relations Act[12] and the Basic Conditions of Employment Act 1997[13]. The improvements brought about by these amendments will be considered hereunder.

In chapter two the labour rights of employees as enshrined in the Constitution[14] will be articulated. This is very important because the Constitution is the supreme law of the country and any law inconsistent therewith is invalid.[15] Further chapter two will discuss the interpretation of the labour rights by the Constitutional Court with a view to distilling the emerging jurisprudence from that Court on labour rights.

1.2 Aims and rationale of the study

This dissertation is intended to benefit law makers, law students, law lecturers and the workers. It will be argued at the end of this dissertation that the present protections accorded to employees in the event of insolvency of their employers are inadequate. Loss of jobs as result of insolvency is nothing new in South Africa. This position has worsened over the past 10 years. The present amendments to the Labour Relations Act 66 of 1995 and Insolvency Act 24 1936 as amended have improved the position of

[11] Insolvency Amendment Act 33 of 2002 and Insolvency Second Amendment Act 69 of 2002.
[12] Labour Relations Amendment Act 12 of 2002
[13] Basic Conditions of Employment Amendment Act 11 of 2002
[14] Act 108 of 1996
[15] Section 2

employees with regard to consultation, information and security of employment but the liquidator could still terminates contracts of employment if no agreement was reached at the consultation.[16] Further transfers do not give adequate protection as well. On the transfer of an insolvent company, unless otherwise agreed the accrued rights and obligations remains with the old employer[17] who at that point in time may not have sufficient assets to meet his obligations to the employees.

Section 98A of the Insolvency Act 24 of 1936 has improved the ranking of claims of employees but those claims are not guaranteed.

South African rescue legislation is antiquated as compared to European Union modes of rescue. Rescue in this sense means the resuscitation of a company which is on the brink of economic collapse and in this way jobs are saved. The United Kingdom has replaced the old administration rescue regime with a new administration regime which restricts the involvement of the courts. In Germany there are insolvency plans which involve debtor and creditor negotiations. All these rescue procedures are geared at rescuing a company which is in financial difficulties before liquidation becomes a reality. In this way employees' jobs are saved.

In the light of the above it will be argued that South Africa needs to reform its rescue legislation and establish guarantee institutions that will meet the claims of employees should an insolvent employer fail to meet them.

1.3 Literature review

The previous researchers in this field of law such as Professor Marius Olivier dealt with the matter when the Insolvency Act 24 of 1936 was not yet amended. My point of departure is to establish to what extent the workers' rights have been taken into account in the amended Acts. Further there are new developments in the Member States of the European Union, for instance in the United Kingdom the Transfer of Undertakings Protection of Employment Regulations 1981 were amended by the Transfer of Undertakings Protection of Employment Regulations 2006. The new regulations came

[16] Section 38(4) Insolvency Act 24 of 1936
[17] Section 197 A (2) (b) (c)

into operation with effect from the 6 April 2006.[18] These regulations provide employment rights to employees when their employer changes as a result of the transfer of the business undertaking. The regulations implement the European Community Acquired Rights Directive 77/187/EEC as amended by Directive 98/50 EC and consolidated in Directive 2001/23/EC.[19] So far I have not yet come across an article where previous researchers have dealt with these regulations. The Regulations apply also to insolvent undertakings. This necessitated me to make an in depth research on the Directive to put the reader in a holistic picture of the workings of the transfer of undertakings at European Union level, hence, the United Kingdom and Federal Republic of Germany were chosen as country studies in my dissertation.

Before I could compare the South African system of transfer of undertakings with transfers at the European Union level, the author undertook research to establish as to whether member states are abiding with the provisions of the Directive or the Directive is just a letter on the paper, hence this dissertation dealt with the decided cases dealing with important aspects of the Directive such as implementation, interpretation and failure to transpose the Directive into national laws by member states.

A further new development that took place in the United Kingdom was the abolition of the old administration scheme, that is, the old rescue or rehabilitation of a company in financial distress, and replacing it with the new administration scheme. The old administration scheme was abolished with effect from the 15 September 2003.[20] This research on the rescue proceedings in the United Kingdom and Germany was undertaken with a view to comparing them with rescue proceedings in South Africa.

Presently the Department of Trade and Industry has published a Bill on Rescue Proceeding which this study has referred in the conclusions and recommendations.

My design and approach is considerably different from the design and approach of the previous researchers.

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[18] retrieved http://www.opsi.gov.uk/si/si2006/20060246.htm
[19] retrieved http://www.dti.gov.uk/Files/file2076/pdf
[20] retrieved http://www.meadeking.co.uk/Teams/Insolvency/Insovency-Team-FAQ.htm

1.4 Data collection and methodology

A combination of methods has been used in this research. Most of the study entailed deskbound research which included the collection and analysis of data from books, journals, Acts of Parliament and decided cases etc. An innovative and modern tool that has been used in this study is the internet, due to its being one of the easiest means of access to the rest of the world.

1.5 Scope and limitation of the study

Chapter one is an introductory part to this study. It highlights the aims and objectives of the study. It reviews the literature in this field of law and indicates the point of departure of the author from the literature in this field of law. It outlines the methods used in collecting the information on the study.

Chapter two deals with the labour rights as enshrined in the Constitution. The chapter is intended to articulate that the labour rights are fundamental rights protected under the Constitution. The chapter goes further to illustrate that the Constitutional Court is interpreting these rights extensively in order to give effect to the spirit and purport of the Constitution. It further illustrates that civil rights are also relevant in the sphere of labour relations.

Chapter three deals with the protection of the labour rights of employees on the transfer of undertakings. It first deals with the transfer of undertakings under the common law and the difficulties that used to be encountered thereunder when an undertaking was to be transferred. It further deals with the present position of transfer of undertakings under the Labour Relations Act 66 of 1995 and the improvements brought thereunder to address the plight of the employees.

Chapter four deals with transfer of undertakings in the European Union. It is intended to compare the position of transfer of undertakings under the European Union with the position in South Africa. The chapter discusses Transfer Directive 2001 and Insolvency Directive 1980 which are intended to bring about uniformity in the member states of the European Union on transfer and insolvency of undertakings. The Directives are a guide

to Member States on matters of transfer and insolvency of undertakings. The chapter further discusses implementation of both Directives by member states and the consequences of non-compliance with the provisions of the directives. Two member States, the United Kingdom and the Federal Republic of Germany have been chosen to illustrate the implementation of the Directives by member states.

Chapter five discusses insolvency protection under South Africa law. It discusses the improvements brought about by the amendments of section 38 of the Insolvency Act 24 of 1936. It further discusses present ranking of claims of employees and the severance pay when an undertaking is liquidated.

Chapter six discusses judicial management and compromises or arrangements in South Africa. Judicial management and compromises or arrangements are mechanisms in terms of which an undertaking may be salvaged from economic paralysis and employees jobs saved. The chapter further discusses the shortcomings of both mechanisms. In comparison it discusses rescue mechanisms in the United Kingdom and Germany.

Chapter seven discusses the protection of the rights of employees in the event of insolvency of their employer at international level under ILO Convention 173 of 1992. It discusses outstanding claims of employees protected by way of privilege and guarantee institutions.

Chapter eight contains my conclusions and recommendations. In addition the new Companies Bill on rescue of companies is discussed.

Because of constraints of time and space, the study is confined to South Africa, European countries and International Law's attitude in dealing with issues of insolvency and the transfer of undertakings that might lead to massive loss of jobs. The study covers the current position and makes recommendations on what could be done. The European countries were specifically chosen for comparative perspective because of their advanced system in relation to the issue on hand.

1.6 SUMMARY

This chapter introduces the reader to this study. The study is intended to benefit law makers, law lecturers, student and employees. Previous literature on the subject has been reviewed and taken into account. The point of departure of the author is based on the amendments of various Acts that will be discussed hereunder and the development that took place in the European Union.

In the chapter that follows I will be dealing with the constitutional protection of the labour rights of employees, including protection of these rights when an undertaking is transferred.

CHAPTER 2: LABOUR RIGHTS ENSHRINED IN THE CONSTITUTION

2.0 Introduction

This chapter deals with the labour rights[21] of employees as enshrined in the Constitution of South Africa, Act 108 of 1996. It is important that the labour rights of employees as enshrined in the Constitution should be discussed in this study because the Constitution is the supreme law of the country and all laws must be interpreted against its background. Law or conduct inconsistent with it is invalid and the obligations imposed by it must be fulfilled.[22] Section 1 of the Labour Relations Act states the purpose of the Act is to advance economic development. social justice, labour peace and the democratization of the work place by fulfilling its primary objects, inter alia, to give effect to and regulate the fundamental rights conferred by section 23 of the Constitution and to give effect to obligations incurred by the Republic as a member state of the International Labour Organization. In this chapter the intention is to show how labour rights have been interpreted by the courts to give effect to the spirit and purports of the Constitution.

2.1 Interpretation of the labour rights by the courts

The South African Constitution,[23] hereinafter referred to as the Constitution, protects the labour rights of both the workers and the employees. Section 23 of the Constitution enshrines labour rights. Section 23(1) guarantees to every one the right to fair labour practices. In instances where the Labour Relations Act 66 of 1995 fails to adequately protect the labour rights of the employees. the Constitution has always provided a remedy in terms of section 23 thereof. In Nehawu v University of Cape Town[24] the employer, the University of Cape Town, outsourced certain of its non-core activities. The question in issue here was whether outsourcing constituted a transfer of business as contemplated in section 197(1) (a) of the Labour Relations Act? The Labour Court and the Labour Appeal Court having decided that it did not, the Union appealed to the Constitutional Court.

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[21] Section 23 Act 108 of 1996
[22] Section 2 Act 108 of 1996
[23] Act 108 of 1996
[24] 2003(3) SA 1 (CC)

The Constitutional Court held that section 197(1) (a) of the Labour Relations Act must be interpreted in the light of section 23(1) of the Constitution, that section 23(1) balanced the interests of employers and those of employees on terms that are fair to both and therefore section 197(1) (a) had to be construed in the sense that it facilitated commercial transactions and protected workers against job losses[25]. It concluded that upon the transfer of a business as a going concern as contemplated in section 197(1)(a) workers were transferred to the new employer. The fact that there was no agreement to transfer the workforce as part of transaction between the University of Cape Town and contractors, that is, new employers did not, as a matter of law, prevent a finding that outsourcing was a transfer of a business as a going concern[26].

If the Constitutional Court could not have closed this loophole it would have been easier for the employers to outsource viable parts of an insolvent company and place it in liquidation. The result would be that the claims of employees would not be met because no assets would be available from which such claims could be satisfied.

Section 23(2) (a) (b) and (c) protects labour rights of the employees relating to freedom of association. In terms of this section employees have the right to strike for their rights, to join trade unions of their own choice and to participate in the activities and programmes of a trade union. The provisions of this section were invoked in the case of South African National Defence Force Union v Minister of Defence.[27] Section 126B(1) of the Defence Act, 44 of 1957 provided that no member of the Permanent Force could be or become a member of a trade union as defined in section 1 of the Labour Relations Act 28 of 1956. The applicant (Union) argued that the prohibition on membership of the Union was in breach of section 23(3) of the Constitution while the respondent argued that members of the permanent force did not constitute "workers" as referred to in section 23 of the Constitution and that even if they did constitute workers the consequent infringement of their rights was justified in terms of section 36[28] of the Constitution. The Court considered section 39 of the Constitution which mandates it to consider international law when interpreting the Bill of Rights.

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[25] p. 21 para 40, and p. 26 para 46
[26] p. 33 para 77
[27] 1999(4) SA 469 (CC)
[28] p. 483 para 19

The Court considered Article 2 of the Freedom of Association and Protection of Rights to Organise Convention 87 of 1948 which provides that, "workers" and employees without distinction whatsoever shall have the right to establish and, subject only to rules of the organization concerned, to join organization of their own choosing without previous authorization". Article 9 of this Convention provides that, "the extent to which the guarantees provided for in this Convention shall apply to armed forces and the police shall be determined by national laws".

The Court found that the Convention, subject to national law of member states, did include armed forces and the police. Following the provisions of Article 2 of the Freedom of Association and Protection of Rights to Organise Convention, 87 of 1984, the Court held that section 23 had to be interpreted to include members of the armed forces, even though the relationship they had with the Defence Force was unusual and not identical to an ordinary employment relationship. It concluded that members of the permanent force constituted "workers" for the purpose of section 23(2) of the Constitution and it must follow therefore that the provision of section 126B(1) of the Defence Act infringed their rights to form and join trade unions were unconstitutional and, therefore, null and void.[29]

In the case of National Union of Metalworkers of SA v Bader Bop (Pty) Ltd and Others[30], the Constitutional Court had to deal with the right to strike by a minority union. Section 14 of the Labour Relations Act confers upon a trade union that has as members a majority of employees employed in the workplace, the organizational right to elect a shop steward to represent its members in grievance and disciplinary proceedings. The employer refused to grant to the union organizational rights in terms of section 14 of the Labour Relations Act because the union was not representative of the majority of employees in the workplace. The dispute was referred to CCMA but was not resolved. The Union informed the employer of its intention to institute strike action. The employer approaches the Labour Court for an interdict. The labour Court dismissed the application. The employer approached the Labour Appeal Court and it granted the interdict. The Union approached the Constitutional Court, arguing that on the correct interpretation of the relevant provision, that is section 14 of the Labour Relations Act by the Labour Appeal Court, the provision constituted an infringement of

[29] p. 483 to 484
[30] 2003 24 ILJ 305 (CC)

the right to strike enshrined in section 23 of the Constitution. The Constitutional Court considered jurisprudence of the Committee of Experts of the International Labour Organisation on freedom of association and held that the jurisprudence of the Enforcement Committee of the International Labour Organisation would suggest that a reading of the Act which permitted the minority unions the right to strike over an issue of shop steward recognition, particularly for the purpose of representation of union members in grievance and disciplinary proceedings would be more in accordance with the principle of freedom of association entrenched in the ILO Conventions.

Similarly, it would avoid a limitation of the right of freedom of association in section 18 of the Constitution and the right of workers to form and join trade unions and the right to strike .....[31]. The Constitutional Court concluded that the relevant provisions of the Act (LRA) could be read so as to avoid the limitation of fundamental rights occasioned by the interpretation placed upon this provision by the Labour Appeal Court. Further that the union (Numsa) was entitled to; (a) seek the organization right relating to shop steward recognition outside the ambit of Chapter VII (of LRA); and (b) embark on strike action in pursuit of such organizational rights[32].

From these cases it is evident that the Constitutional Court is interpreting section 23 of the Constitution extensively and generously. It has extended the coverage of section 23 to situations where the workers would ordinarily not have been entitled to a remedy under the Labour Relations Act. The relevance of this section in insolvency related retrenchments, that is, major retrenchments is that the workers have the right to strike whenever their rights are at stake or threatened.

In addition to labour rights entrenched in section 23 of the Constitution, the Bill of Rights contains provisions guaranteeing specific fundamental rights relevant to the sphere of labour relations. Section 33 of the Constitution confers to everyone the right to administrative action that is lawful, reasonable and procedurally fair. The effect of this section is that, every person, including an employee, who is adversely affected by a decision of an administrative body must be given an opportunity to state his/ her side of story. Where a decision of an administrative body is based on its policy such a policy must be disclosed to a person affected thereby. In the case of Tseleng v The Chairman

[31] p. 324 para 34 to 36
[32] p. 337 para 76

Unemployment Insurance Board and Another,[33] the Court was asked to review the policy of the Unemployment Insurance Board in terms of which the granting of additional benefits (as provided for by section 35 of the Unemployment Insurance Act 30 of 1966) was made subject to the requirement that the applicant must satisfy the Board that he/ she actively sought work while receiving initial unemployment benefits. Amongst other things, the Court found the policy to be unconstitutional, owing to the fact that the policy had not been disclosed to the applicant. The failure to disclose the policy amounted to a breach of the applicant's fundamental rights to procedurally fair administrative action, conferred by section 24 of the Interim Constitution[34].

Section 9 of the Constitution provides for equality before the law. It outlaws unfair discrimination. This right is also applied in the sphere of labour law. In the case of Hoffmann v SAA,[35] SAA refused to employ the appellant as flight attendant arguing that he was unfit for world wide duty because of his HIV status. The Constitutional Court held that, the refusal by SAA to employ the appellant as a cabin attendant violated his right guaranteed by section 9 of the Constitution. It ordered that SAA offer the appellant employment forthwith which offer was to be accepted with 30 days failing which it would lapse.

Section 16 also has been used in the sphere of labour law in the context of public protest.[36].

2.2 Obligations of the state under section 7(2) of the Constitution

The Constitution obligates the state to fulfil constitutional duties[37]. The Constitution requires the state to respect, protect, promote and to fulfil the rights in the Bill of Rights.[38] Brand in his Introduction to Socio-Economic Rights in the South African Constitution[39]succinctly explained the practical implication placed on the state by

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[33] 1995 16 ILJ 830 (T)
[34] Now section 33
[35] 2001(1) SA 1 (CC)
[36] South African National Defence Union v Minister of Defence Ibid. no.27 at p 476-477; also Namibian Case of Kauesa v Minister of Home Affairs and other 1995(11) BCLR 1540 (NMS)
[37] Section 2
[38] Section 7 (2)
[39] Brand, D; "Introduction to Socio Economic Rights in the South African Constitution" in Brand, D: and Heyns, C; (eds) Socio Economic Rights in South Africa (Pretoria University Press, Pretrial) 2005

section 7(2) of the Constitution. Labour rights are also socio-economic rights.[40] The labour rights contained in section 23 of the Constitution differ from other social and economic rights in that they are not directed at material state performance such as provision of facilities and delivery of services, but at a relationship between private parties. As such, have a direct horizontal effect, unlike other socio-economic rights which mainly have vertical application due to state involvement in the relevant power relationship.[41]

Brand has pointed out that the duty to protect requires the state to protect the existing enjoyments of rights, and the capacity of people to enhance their enjoyment of rights or newly to gain access to the enjoyment of rights against third party interference.[42] In the context of employment the state should, for instance, regulate conditions of employment to protect employees against exploitation by employers and should through such regulation provide effective legal remedies where such exploitation or other forms of interference occur. He pointed out that, the other aspect of this duty that was often overlooked is the duty of the courts, through their powers of developing the common law and interpreting the legislation, to strengthen existing remedies or develop new remedies for protection against private interference in the enjoyments of rights.[43]

He described the duty to promote as a duty to raise awareness of rights, to bring rights and the method of accessing and enforcing them to the attention of rights holders and to promote the most effective use of existing access to rights.[44] Further it was the duty on administrative bodies to use the promotion of socio economic rights as a primary consideration in their discretionary decision-making, much like the constitutional injunction contained in section 28 (2) requires that the best interest of the child be the primary consideration in the decision affecting the child.[45]

He stated that the duty to fulfil requires the state to act, "adopt appropriate legislative, administrative, budgetary, judicial, promotional and other measures, so that those that

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[40] Mubangizi, J; "The Constitutional Protection of Socio-Economic Rights in Selected African Countries: A Comparative Evaluatio," 2 African Journal of Legal Studies (1) (2006) 1-19
[41] Mubangizi Ibid. no. 40 at p. 5
[42] Brand Ibid. no. 39 at p 10.
[43] Brand Ibid. no. 39 at p 10.
[44] Brand Ibid. no. 39 at p10.
[45] Brand Ibid. no. 39 at p.10

do not currently, enjoy access to rights should gain access so that existing enjoyment of rights was enhanced.[46]

Brand has pointed out that a distinction is often made between positive duties (doing something) and negative duties (refrain from doing something).[47] The duties to respect were classified as negative duties whereas the duties to protect, promote and fulfil were described as positive duties. He has pointed out that, in reality, the distinction between positive and negative duties is little more than a semantic distinction, because the same conduct of the state could be described both as breach of positive duty to fulfil the right and a negative duty to respect. He gave an example of a situation that arose in the case of Minister of Health v Treatment Action Campaign,[48] where it was not clear whether the refusal to extend the provision of Nevirapine to all public health facilities constituted a negative interference in or impairment of the right to have access to health care services or a failure of the state positively to provide an essential health service. He concluded by saying that the distinction did not hold up.

2.3 Judicial enforcement

Section 38 of the Constitution grants to anyone, whether acting in person, represented, or acting in a representative capacity the right to approach the courts for enforcement of his constitutional rights or of those he represents when these rights have been infringed or threatened. It is mainly through judicial enforcement, that the realization and enjoyment of socio-economic rights take place.[49]

The Bill of Rights binds the judiciary as well as the legislature and Executive.[50] Therefore the courts are under an obligation to interpret the Bill of Rights in such a way as to give effect to the purport and spirit of the Constitution. The Constitution mandates the courts to develop the common law in their interpretive functions to reflect the spirit, purport and objects of the Bill of Rights.[51] The obligation of the courts to develop the common law, in the context of section 39 (2) objectives is not purely discretionary. On the contrary, it is implicit in section 39 (2) read with section 173 that where the

[46] Brand Ibid. no. 39 at p 10.
[47] Brand Ibid. no. 39 at p 10.
[48] 1996 (4) SA 744 (CC).
[49] Mubangizi Ibid. no 40 at p. 6
[50] Section 8(1)
[51] Section 39(2)

common law as it stands is deficient in promoting the section 39 (2) objectives, the courts are under a general obligation to develop it appropriately.[52] The courts are mandated to consider international law and may consider foreign law in executing their interpretive functions.[53]

2.4 SUMMARY

This chapter dealt with labour rights as enshrined in the Constitution and the interpretation of these rights by courts. The obligations placed of the state by the Constitution to respect, protect, promote and to fulfil the Rights in the Bill of Right have been articulated. The obligation imposed by the Constitution on the courts to give effect to purport and spirit of the Constitution when enforcing these rights has also been discussed. It is important to note that all these rights may be limited in terms of the limitation clause contained in section 36 of the Constitution.

In the chapter that follows I am going to deal with the transfer of undertakings and the interpretation of some of the provision of the Labour Relations Act by the courts relating thereto.

[52] Carmichele v Minister of Safety and Securtiy 2001 (1) S A 938 (CC) at 955
[53] Section 39 (1) (b) (c)

CHAPTER 3: PROTECTION OF EMPLOYEES' RIGHTS UNDER THE LABOUR RELATIONS ACT

3.0 Introduction

This chapter is aimed at articulating the protection of employees under the Labour Relations Act 66 of 1995. First it is proposed to deal with the problems that used to be experienced under the common law when an undertaking was to be transferred as a going concern, followed by the protection brought about by the Labour Relations Act.

3.1 Common Law position

In terms of the common law, a contract of service of an employee could not be transferred or ceded to a new employer without the consent of an employee.[54] It was difficult to transfer a business undertaking together with workers without first obtaining their consent.[55] In most cases the employers resorted to dismissing the employees because the system saved time and costs of transfer.[56] The employees were left to negotiate employment with the new employer on whatever terms he could offer to them. The result was that, there was no guarantee of employment on similar terms and conditions, nor would there be any recognition of the years of service with the old employer or accrued benefits.[57] A need was felt that a law should be enacted that would facilitate business transfers in such a way as to ensure that the rights of employees were adequately protected. Section 197 of the Labour Relations Act 66 of 1995 was enacted to fill that gap. [58] In terms of section 197, individual employees can now be transferred without their consent and cannot prevent the transfer to a new employer without agreement to that effect in terms of section 197(6) of the Labour Relations Act 66 of 1995 or their resignation[59]. Prior to its amendment section 197 regulated transfers of businesses under solvent and insolvent circumstances. It was amended[60] by substituting it with a new section 197 and the insertion of section 197A. Section 197A now

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[54] Bosch, C.; "Balancing the Act: Fairness and Transfer of Business" (2004) ILJ Volume 25 no 4-6 925
[55] Bosch Ibid. no. 54 at p. 925
[56] Bosch Ibid. no. 54 at p. 925
[57] Bosch Ibid. no. 54 at p. 925
[58] Bosch Ibid. no. 54 at p. 926
[59] Bosch Ibid. no. 54 at p. 936
[60] Act 12 of 2002

regulates transfers of undertakings under insolvent circumstances. The new section 197(1) provides that in this section and section 197A:–

- 'business' includes the whole or part of any business, trade, undertaking or service; and
- 'transfer' means the transfer of business by one employer (the old employer) to another employer (new employer) as a going concern.

3.2 Transfer of a business as a going concern

The courts have been grappling with the interpretation of the phrase 'as a going concern'. The Constitutional Court has however given guidance as to the correct or proper interpretation of that phrase in the case of National Education Health and Allied Workers Union v University of Cape Town[61]. The Constitutional Court has held that the phrase, "as a going concern", is not defined in the Labour Relations Act. It must therefore be given its ordinary meaning unless the context indicates otherwise. What is transferred must be a business in operation so that the business remains the same but in different hands. Whether that has occurred is a matter of fact which must be determined objectively in the light of the circumstances of each transaction. In deciding whether a business has been transferred as a going concern, regard must be had to the substance and not the form of transaction. A number of factors will be relevant to the question whether the transfer of business as a going concern has occurred, such as the transfer or otherwise of assets, both tangible and intangible, whether or not the workers are taken over by the new employer, whether customers are transferred and whether or not the same business is being carried on by the new employer. What must be stressed is that this list of factors is not exhaustive and that none of them is decisive individually. They must all be considered in the overall assessment and should not be considered in isolation.

3.3 Transfer of contract of employment

Where an existing business is transferred as a going concern in circumstances of the insolvency of the employer, the provisions of section 197A will apply to all contracts of

[61] Ibid no. 24 at p. 28

employment in existence between an employer and each employee after the grant of sequestration or winding up of the insolvent employer and the result will be that despite Insolvency Act 24 of 1936 and subject to the provision of section 197(6), all contracts of employment in existence immediately before the old employer's provisional winding up or sequestration are transferred to the new employer[62]. The effect of this is that despite the fact that the liquidator or trustee may have terminated contracts of employment in terms of section 38(4) of the Insolvency Act or contracts of employment may have terminated automatically in terms of section 38(9), such a contract of employment would have revived in terms of section 197A[63].

It will be remembered that, under the previous section 197 uncertainties prevailed as to what would happen to contracts of employment if after having been terminated in terms of the old section 38 the business of the insolvent employer was transferred as a going concern. The question was whether those contracts of employment were revived or not. Section 197 has cleared this uncertainty. However, unless otherwise agreed in terms of section 197 (6), all the rights and obligations between the old employer and each employee at the time of transfer remain rights and obligations between the old employer and each employee.[64] This is perfectly understandable because it would be unfair for the new employer to be saddled with labour problems to which he was not a party. Further this would make the transfer of business under insolvent circumstances less attractive and on the other hand stifle economic development. Further anything done before the transfer by the old employer in respect of each employee is considered to have been done by the old employer.[65] It is also clear from this subsection that the legislature's intention was to facilitate a clear transfer to the new employer, when a business is transferred in insolvent circumstances, the aim being to make the transfer or sale of a business in insolvent circumstances more attractive. One of the advantages created by section 197A for the employees is that, the transfer or sale of a business in insolvent circumstances does not interrupt employee's continuity of employment. The contract of employment continues with the new employer as with the old employer.[66] The service records of the employees are not tempered with and this works favourably for the retirement pension fund of the employees. However, one must bear in mind that

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[62] See section 197(2)(a)
[63] Bosch Ibid. no. 54 at p. 938
[64] Section 197A(2)(1)(a)
[65] Section 197A(2)(1)(b)
[66] Section 197A(1)(c)

the provisions of section 197A (2) (1) (a) (b) (c) and (d) may be varied by an agreement in writing in terms of section 197(6) concluded between either the old employer, the new employer, or old and new employer acting jointly on the one hand and the appropriate person or body (union) referred to in section 189(1) on the other hand. Section 197A makes section 197(3) (4) (5) and (10) applicable to transfer.

Section 197(3) envisages a situation where there has been an agreement in terms of section 197(6) to vary the conditions of employment of the employees on transfer. The protection accorded to the employees in such a case is that the new employer in order to comply with the provisions of this section must offer to the employees terms of employment that are on the whole not less favourable than those that were offered to them whilst still under the employment of the old employer.

An employee is allowed to be transferred to a pension fund, provident, retirement or similar fund other than the fund to which the employee belonged prior to transfer, if the criteria in section 14(1)(c) of the Pension Fund Act, 1956 (Act No 24 of 1956) are satisfied. The criteria referred to in section 14(1) (c) of Pension Fund Act, 1956 (Act No 24 of 1956) are that the Registrar of the Pension Fund is required to be satisfied that any scheme to amalgamate or transfer funds is reasonable and equitable, and accords full recognition to the rights and reasonable benefit expectations of the persons concerned in terms of the fund rules and to additional benefits which have become established practice.[67]

The new employer is bound by an arbitration award or collective agreement that was binding on the old employer immediately before the provisional winding up or sequestration.[68]

Collective agreements, as an end product of collective bargaining, play a larger role in labour law than individual contracts of employment. Collective agreements may regulate rights and obligations between employer and union parties as well as the terms and conditions of employment of individual employees, where employees are subject to collective agreement its relevant provisions are treated as implied terms of contract of employment.

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[67] Section 197 (4)
[68] Section 197 (5) (b)

A collective agreement may not be amended by means of contract of employment, any other contract or a provision in such a contract. The amended agreement or provision will be invalid[69] or may constitute an unfair labour practice. In the case of Intercompany Security Services (Cape) (Pty) Ltd v Transport and General Workers Union,[70] the appellant and the respondent entered into an agreement in terms of which "redundancy" was deemed to occur if employees were laid off or reduction of an activity for the purpose for which they were employed.

However, the agreement defined retrenchment as the termination of an employees' contract of employment because of a shortage of work. Pursuant to the sale of its business to a third party, the appellant terminated the employment of all its employees. It refused to pay the retrenchment benefits set out in the agreement on the basis that the retrenchment provision only applied to the termination of employment relationship pursuant to a shortage of work and not closure of the entire business. The Industrial Court disagreed with appellant's interpretation of the agreement and found that its failure to pay retrenchment benefits to the retrenched employees constituted an unfair labour practice.[71]

Further no provision in a contract of employment or any other contract could:-

- permit an employee to be paid less remuneration than that prescribed in a collective agreement or arbitration award:[72]
- permit an employee to be treated in a manner or receive a benefit that is less favourable that stipulated in a collective agreement;[73]
- waive any benefits in a collective agreement .[74]

If any of the above provisions formed part of any agreement it would be invalid.[75]

A collective agreement may be terminated on the date agreed upon by the parties or if it was concluded for an indefinite period, any of the parties may terminate the agreement

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[69] Section 192
[70] 1995 16 ILJ 854 (LAC)
[71] Ibid. no. 70 at p. 863
[72] Section 199 (1) (a)
[73] Section 199 (1) (b)
[74] Section 199 (1) (c)
[75] Section 199 (2)

by giving reasonable notice to the other.[76] In the case of National Union of Metalworkers of SA v Duferco Steel Processing (Pty) Ltd,[77] the parties concluded a collective agreement to govern the process of changing the terms and conditions of employment in the industry from a cost-to-company basis to an hourly rate basis. The new terms and conditions were then drafted into the individual contracts of employment of the affected employees. The agreement did not have a variation clause or a termination clause. The union party gave notice of its intention to terminate the agreement which the employer did not accept. After examining the content of the agreement the Commissioner found that it dealt mainly with matters of mutual interest that had been negotiated in good faith. The new terms and conditions agreed had already been implemented and would not be changed by cancellation of the agreement. Similarly, the dates for implementing transitional arrangements had come and gone and they would not be affected by cancellation. The Commissioner concluded that section 23 (4) provided for the cancellation of the agreement concluded for an indefinite period on reasonable notice. The notice given by the union was reasonable and the agreement could therefore be cancelled.[78]

A collective agreement is not automatically terminated by provisional liquidation. In the case of Clothing and Textile Workers' Union and others v Waverly Blankets Ltd,[79] employees were dismissed for various acts of misconduct. The dismissal disputes were still pending when the company was placed under liquidation. Prior to the liquidation the company entered into a recognition agreement with the union party in terms of which disputes of rights had to be referred to arbitration. After a scheme of arrangement was adopted, and agreement was concluded between the union and the company which provided, inter alia, that the company's new management would take over the existing procedural agreements between the parties.

The union referred a dispute to CCMA, seeking a determination that a company was bound by a collective agreement and that the dismissal dispute had to be arbitrated in terms of the agreement. The company argued that whilst the recognition agreement had

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[76] Section 23 (4)
[77] 2003 16 ILJ 1610 (CCMA)
[78] National Union of Metal Workers of SA v Duferco Steel Processing (Pty) Ltd Ibid no. 77 at p 1613
[79] 1999 20 ILJ 2744 (CCMA)

been tacitly renewed on same terms and conditions as existed prior to the liquidation and the adoption of the scheme of arrangement. any obligation it might have had to refer the dismissal dispute to arbitration were extinguished by the provisional order of liquidation and the adoption of the scheme.

The Commissioner found that section 38 of the Insolvency Act regulated the termination of individual employments contracts but it was silent on the fate of any collective agreement that might exist between the employer and its employees or for that matter their representative union. He concluded that the recognition agreement has not been terminated and that the dispute relating to the dismissal of the union members for the alleged acts of misconduct had to be referred to arbitration in terms of the agreement.[80]

3.4 Disclosure of information concerning insolvency.

Section 197B requires an employer who is experiencing financial difficulties that may reasonably result in the winding up or sequestration of an undertaking to advise a consulting party referred to in section 189(1). The consulting party referred to in section 189(1) is any person whom the employer is required to consult in terms of collective agreement:- [81]

- a workplace forum or registered trade union;[82]
- the employees themselves or their representatives.[83]

The importance of these provisions is that the employees will know at an early stage about the problems that the company is facing. They will therefore be in a position to take steps that are necessary to protect their rights. This they can do by requiring the employer to consult with them to see as to what could be done to save the business or could in the interim seek new employment. In terms of section 197B (2) (a) the employer is required to provide the consulting party with a copy of an application when applying to be wound up or sequestrated. It is submitted that this provision entitles the employees themselves or through their representatives to file an opposing application if

[80] Ibid no. 79 at p. 2752
[81] Section 189 (1) (a)
[82] Section 189 (b) (i) (ii)
[83] Section 189 (d).

they so wish to challenge the allegations made by an employer in his application and could in their application as an interim measure interdict an employee from proceeding with the application pending the negotiations. Further the employees or their representatives are entitled to request the court to order the employer to consult with them so that they could be in a position to make proposals in connection with pending sequestration or liquidation. It is submitted that the principles of consultation enunciated by the courts in interpreting section 189 will equally apply to transfer under section 197A.

In terms of section 197B (2) (b) an employer who receives an application from a creditor for sequestration or winding up is required to furnish the consulting party contemplated in section 189(1) with the application within two days of receipt thereof or if the proceedings are urgent within 12 hours. It could have been difficult in the past for the employees or their representatives to know when the creditor has launched such an application. Today the employees or their representatives are entitled as of right to be informed of such an application. My submissions above will equally apply in this regard.

3.5 Protection against dismissals

Section 186 has been amended to bring about a new category of dismissal in addition to dismissal categories listed thereunder.[84] This amendment is aimed at protecting, "an employee (who) terminates a contract of employment with or without notice because the new employer, after transfer in terms of section 197A, provided an employee with conditions or circumstances at work that are substantially less favourable to the employee than those provided by the old employer". The implication is that the new employer can effect changes to the conditions and circumstances of employment if only they are not substantially less favourable than those which existed with the old employer.

If an employee can prove that the new employer has effected changes which are substantially less favourable than those which were provided by the old employer then in that event the changes brought about by the old employer will constitute constructive

[84] Section 41(b) Act 12 of 2002

dismissal[85]. Section 187 has also been amended by section 42 of Act 12 of 2002 to provide for automatically unfair dismissal. The dismissal will be automatically unfair if an employee is dismissed by reason of transfer contemplated in sections 197 and 197A[86] of the Labour Relations Act 66 of 1995. The section is applicable before and after transfer.[87]

3.6 Compensation

For all other forms of unfair dismissals compensation may not exceed 12 months remuneration calculated at the employer's rate of remuneration on the date of dismissal. For automatically unfair dismissal compensation may not exceed 24 months remuneration calculated at the employee's rate of remuneration on the date of dismissal. The compensation must be just and equitable in all circumstances. The term "just and equitable in all circumstances" implies that compensation must be fair to both the employer and unfairly dismissed employee.[88] The court has discretion as to the quantum of compensation[89]. The court may order reinstatement with payment of arrears of salary so that an employee is put in a position he would have been had he not been dismissed.[90] The draw-back with section 197A transfers is that the employees are not transferred with their acquired rights. Their rights and obligations remains with the old employer who might not have assets to meet his obligations to the employees.

3.7 Summary

This chapter dealt with the position of the employees on transfer of the undertakings before the enactment of the Labour Relations Act 66 of 1995 and after its enactment. Before the enactment of the Labour Relations Act employees enjoyed no protection when an undertaking was to be transferred to a new employer. The reason for this was that, in terms of the common law, a contract of employment was regarded as a personal contract between the employer and an employee. Therefore contract of employment

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[85] Bosch Ibid. no 54 at p. 937
[86] Section 187(1)(g)
[87] Boraine, A. and van Eck, S.: "New Insolvency and Labour Legislative Package: How successful was the Integration" (2003) (24) ILJ 1859
[88] D du Toit et al Labour Relations Law: A Comprehensive Guide, 4th Edition Durban 2003, 453
[89] SA Clothing and Textile Workers Union and Others v Rubin (2003) 24 Industrial law journal 429 at 435 (LC)
[90] Food Allied Workers Union v General Food Industries Ltd (2002) 23 Industrial Law Journal, 1829 at para 56.

could not be transferred without the consent of the employee. The new employer who took over the business was also not bound to take over the employees of the old employer. Employees were left to the mercy of the new employer who, should he elect to take them over, could dictate whatever terms he could wish to offer to them. In short, at common law the transfer of undertakings were not regulated and this worked unfavourably against the employees.

Since the enactment of the Labour Relations Act, transfers of undertakings are statutorily regulated. Since then employees enjoy continued employment where the undertaking or part thereof is transferred as a going concern. The contracts of employment of employees employed by the transferor immediately prior to the transfer are transferred to the transferee.[91] This applies to transfers of undertakings in both solvent and insolvent circumstances.[92] Furthermore, the transfer of undertaking does not affect continuity of employment of the transferred employees. In Nehawu v University of Cape Town and Others[93], the Constitutional Court held that upon the transfer of a business as a going concern, workers are transferred to the new owner. This decision endorses the interpretation of section 197 that automatic transfer of employment contracts ensues whenever there is a transfer of business, trade or undertaking or part thereof as a going concern. The fact that there was no agreement between the transferor and transferee to transfer the workforce did not, as a matter of law prevent a finding that outsourcing was a transfer of a business as a going concern.

For the purposes of comparison I am going to deal with the transfer of business undertakings at European Union level in the chapter that follows. The intention is to establish as to whether there are lessons that could be learnt from law and practice at European Union level.

[91] Section 197(2) (a)
[92] Section 197 and 197A
[93] Ibid no. 24

CHAPTER FOUR: COMPARATIVE STUDY

4.0 Introduction

This chapter deals with the transfer of undertakings under the European Union and protection of employees' rights in the event of insolvency of their employer. The intention in this chapter is to compare the position under the European Union with the position in South Africa discussed in the preceding chapter. Under the European Union there are two important Directives that deal with the rights of employees in the event of insolvency of their employer or when the undertaking is transferred to a new employer irrespective of whether it is solvent or insolvent. These Directives are, Transfer Directive of 2001 and Insolvency Directive of 1980. Both Directives contain binding stipulations on member states.

However member states are given discretion to decide whether or not the normal safeguards contained in the Transfer Directive will apply in the event that an undertaking to be transferred is a subject of bankruptcy proceedings. If a member state opts that it will not apply, such a member state should make provision for the protection of employees' rights at least equivalent to that provided by the Insolvency Directive of 1980. The Insolvency Directive 1980 provides the framework for regulating the guaranteed payment of certain benefits. It will be discussed hereunder.

In terms of the Transfer Directive, employees' representatives should be properly consulted, even in the context of insolvency proceedings. This constitutes an important procedural step which gives employees an opportunity to also make suggestions as to what could be done to save the company and preserve employment.

As a prologue I will first deal with the transfer of undertakings under the European Union Directive 2001/23/EC followed by practice in the member states, namely Germany and the United Kingdom. Secondly I will discuss the Insolvency Directive 1980 and the implementation thereof by member states and lastly the interpretation of this Directive by the courts.

4.1 Transfers: European Union

Under the European Union transfer of undertakings were previously regulated under Council Directive 77/ 187/ECC of 14 February 1977 on the approximation of laws of member states relating to safeguarding of employees' rights in the event of transfers of undertakings, business, or parts of undertakings or business. This Directive has been substantially amended by Council Directive 98/50/EC of July 1998, in the interest of clarity and rationality. It has now been codified in Council Directive 2001/23/EC.[94]

The transfer of undertakings in the European Union is presently regulated under this Directive. In principle the Directive applies also to insolvent undertakings but subject to certain limitations.

4.1.1 Scope of the Directive

The Directive applies "where and insofar as the undertaking, business or part of the undertaking or business to be transferred is situated within the territorial scope of the Treaty[95] or a member country of the European Economic Area.[96]

4.1.2 Undertakings covered by the Directive

The Directive applies to economic entities which constitute organised groupings of resources having the objective of pursuing an identifiable economic activity.[97] According Article 1(1) (c), the Directive applies to any type of undertakings whether they are pubic or private and whether or not they are operating for gain.

The essential element for the characterisation of an entity as undertaking or business is that this entity is engaged in economic activities, that is, it provides goods or services in the open market. Activities involving the exercise of public authority do not fall within the scope of the Directive.[98]

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[94] L82/16 Official Journal of European Communities dated 23 March 2001 Annex, 1 Part A.
[95] Article 1 (2)
[96] Norway, Iceland and Leichtenstein
[97] Article 1 (1) (b)
[98] Retrieved http://ec.europa.eu/employment_social/labour_docs/transfer_memorandum_2004_en.pdf

Also excluded from the scope of the Directive is an administrative reorganization of public administrative authorities, or the transfer of administrative functions between public administrative authorities.[99]

Transfers involving sea-going vessels are explicitly excluded by the Directive[100].

4.1.3 Employees covered by the Directive

The term "employee" refers to any person who, in the member state concerned, is protected as an employee under national employment law.[101] All employees are protected. In this sense, according article 2(2), member states shall not exclude from the scope of the Directive contracts of employment solely because:-

- of the number of the working hours performed or to be perfomed;[102]
- they are employment relationships governed by a fixed-duration contract of employment within the meaning of Article 1 (1) of Council Directive 91/383/EEC of 25 June 1991 supplementing the measures to encourage improvements in the safety and health at work of workers with fixed-duration employment relationship or a temporary employment relationship;[103] or
- They are temporary employment relationship, within the meaning of Article 1 (2) of Directive 91/838/ECC, and the undertaking, business or part of the undertaking or business transferred is, or is part of, the temporary employment business which is the employer.[104]

The Directive does not apply, however, either to employees who have already left the undertaking on the date of the transfer or to employees engaged after the date of transfer or to employees employed by the transferor at the date of the transfer but who, on their own accord, decide not to continue the employment relationship with the new employer after the transfer.[105]

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[99] Article 1 (1) (c)
[100] Article 1 (3)
[101] Article 2 (1) (d)
[102] Article 2 (2) (a)
[103] Article 2 (2) (b)
[104] Article 2 (2) (c)
[105] Retrieved http://ec.europa.eu.employment-social/labour-law/docs/transfer-memorandum-204-en.pdf

4.1.4 Conditions for a valid transfer

For a transfer to take place the following conditions must be met:-

- there must be change of employer;
- the transferred entity must maintain its identity.

4.1.4.1 Change of employer

There must be change, in terms of contractual relations in the legal or natural person who is responsible for carrying on the business and who incurs the obligations of an employer towards employees of the entity. Accordingly, the "term transferor" is defined in the Directive as meaning any natural or legal person who by reason of transfer ceases to be an employer and the term "transferee" as any natural person or legal person who becomes an employer in respect of the undertaking, business or part of the undertaking or business.[106]

The transfer of ownership of most of the shares in a company or a change in the majority shareholders does not constitute a transfer of the undertaking, as the employer's legal personality remains the same.[107]

4.1.4.2 Maintenance of identity

The maintenance of identity is marked both by the continuation by the new employer of the same activities and by the continuity of its workforce, its management staff, the way in which its work is organized, its operational methods or the operational resources available to it. The assessment necessary in order to establish whether or not there is a

transfer are a matters for national courts in view of the interpretational factors involved:-[108]

- Type of undertaking or business;

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[106] Article 2 (1) (a) (b)
[107] Retrieved http://ec.europa.eu/employment-social/labour-law/docs/transfer-memorandum-2004-en.pdf
[108] Retrieved http://ec.europa.eu/employment-social/labour-law/docs/transfer-memorandum-2004-en.pdf

- whether or not tangible assets such as buildings and movable property are transferred;
- the value of intangible assets at the time of the transfer,
- whether or not customers are transferred,
- the degree of similarity between the activities carried on before and after the transfer;
- the period, if any, for which those activities were suspended; and
- whether or not the majority of employees are taken over by the new employer.

However the above circumstances are merely single factors in the overall assessment which must be made and cannot therefore be considered in isolation.[109]

Amongst the above elements, the type of activity carried on by the undertaking is an essential factor since it might determine the degrees of importance to be given to the others. As far as the provisioning of services is concerned the distinction is made between activities based essentially on human capital, such as cleaning and surveillance, and activities based essentially on assets, such as public transport or catering.[110]

Therefore, in the case of providers of services whose activities are based essentially on human capital, the taking over by the new employer of a major part, in terms of the numbers and skills, of the employees specially assigned by his predecessor to the provision of the service in point can result in the maintenance of the identity of the entity.[111]

Similarly, in case of providers of services whose activities are based essentially on assets, the taking over by the new operator of the assets indispensable for the provision of the services can result in the maintenance of the identity of the entity even when the essential part of the staff has not been taken over.

[109] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/transfer_memorandum_2004_en.pdf
[110] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/transfer_memorandum_2004_en.pdf
[111] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/transfer_memorandum_2004_en.pdf

On the contrary, the identity is not maintained where the new operator does not take over the assets indispensable for the provision of the services.[112]

4.1.4.3 The nature of the transaction at the origin of the transfer

The means through which the change of employer takes place is not relevant. In view of the differences between various language versions of Article 1(1) of the Directive and the divergences between national legislation on the concept of legal transfer, its scope cannot be appraised solely on the basis of a textual interpretation. Therefore, a transfer can result from an unilateral act, a judicial decision or law. Similarly there is no need that the transfer results from a direct contractual relationship between the transferee and the transferor.[113]

The European Court of Justice has held that the Directive is applicable to a transfer of undertaking which takes place in the following transactions:[114]

- in the course of procedure such as a "surseance van betaling" (judicial leave to suspend payment of debts);
- where the owner of a leased undertaking takes over its operation following a breach of the lease;
- where, upon the termination of a non-transferable lease, the owner of the undertaking leases it to a new lessee;
- to the transfer of an undertaking pursuant to a lease-purchase agreement by a judicial decision;
- where, after giving notice bringing a lease to an end or upon termination thereof, the owner of an undertaking retakes possession of it and thereafter sells it to a third party;
- where, in accordance with a body of legislation such as that governing special administration for large undertakings in critical difficulties, it has been decided that the undertaking is to continue trading for as long as that decision remains in effect;

[112] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/trandfer-memorandum-2004-en.pdf
[113] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/transfer-memorandum-2004-en.pdf
[114] Retrieved http://ec.europa.eu.employment_social/labour_law/docs/transfer-memorandum-2004-en.pdf

- to a situation in which a public authority decides to terminate the subsidy paid to foundation, which is its only source of income, as a result of which its activities are fully and definitively terminated, and to transfer it to another foundation with a similar aim;
- to a situation in which one entrepreneur, by contract, assigns to another entrepreneur responsibility for running a facility for staff, which was formerly managed directly;
- to a situation in which an undertaking entrusts by contract to another undertaking the responsibility for carrying out cleaning operations which it previously performed itself, even though, prior to the transfer, such work was carried out by a single employee;
- to a situation in which an undertaking holding a dealership for a particular territory discontinues its activities and the dealership is then transferred to another undertaking which takes on part of the staff and is recommended to customers, without any transfer of assets;
- in the event of the transfer of an undertaking which is being wound up by the court if the undertaking continues to trade;
- where a company in voluntary liquidation transfers all or part of its assets to another company from which the worker then takes his orders which the company in liquidation states are to be carried out;
- where an undertaking which used to entrusts the cleaning of its premises to another undertaking decides to terminate its contract with that other undertaking and in the future to carry out that cleaning work itself or trust that task to a third undertaking, if the new employer takes over a major part, in terms of their numbers and skills, of the employees specially assigned by his predecessor to that task; and
- to a situation in which a company belonging to a group decides to sub contract to another company in the same group contracts in so far as the transactions involves the transfer of an economic entity between the two companies.

4.1.5 Consequences of a transfer

4.1.5.1 Transfer of rights and obligations to the transferee

In accordance with the provisions of the Directive, the transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of an transfer are, by reason of such transfer, transferred to the transferee. However, member states may provide that after the date of transfer the transferor continue to be liable, side by side with the transferee, in respect of obligations arising from contract of employment relationship existing on the date of transfer.[115]

The Directive refers unreservedly to the transferor's rights and obligations arising from a contract of employment or from an employment relationship existing at the date of transfer, therefore it is the transferee who assumes, in the first instance, liability for bearing the burden resulting from employees' rights existing on the date of transfer, however without prejudice to the possibility of member states providing for joint liability of transferor and transferee in respect of obligations which arose before the date of transfer.[116]

The transfer of all contracts of employment or employment relationships existing on the date of transfer of an undertaking between the transferor and the workers employed in the undertaking transferred takes place automatically by the mere fact of transfer and may not be made subject to the intention of the transferor or transferee, or the agreement between the employees, without prejudice however, to employee's right not to continue the employment relationship with the transferee.[117]

In calculating the rights of a financial nature attached, in the transferee's business, to employees' length of service, such as termination payment or salary increases, the transferee must take into account the entire length of service of the employees transferred, both in his employment and that of the transferor, in so far as his obligations to do so derives from the employment relationship between those employees and the transferor, and in accordance with the terms agreed in that relationship.

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[115] Article 3 (1)
[116] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/transfer_memorandum_2004_en.pdf
[117] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/transfer_memorandum_2004_en.pdf

The Directive does not however, preclude the transferee from altering the terms of employment relationship where the national law allows such an alteration in situation other than the transfer of an undertaking.[118]

4.1.5.2 Changes to the terms and conditions of employment of the affected employees.

If the contract of employment or the employment relationship is terminated because the transfer within the meaning of the Directive involves a substantial change in working conditions to the detriment of the employee, the employer is regarded as having been responsible for the termination of the employment contract and employment relationship.[119]

Employees' remuneration rights arising from their employment contract or employment relationship may not be changed even if the overall amount of their wages remains unchanged.

However, in so far as national laws makes it possible to amend an employment relationship in a way which is disadvantageous to employees, such changes are not ruled out merely because the undertaking has in the meantime been transferred. Thus the rights and obligations may be changed vis-à-vis the transferee subject to the same restrictions as could have been applied to the transferor, assuming that the transfer in itself is not the reason for this change.[120]

4.1.5.3 Notification of rights and obligations to be transferred

The Directive requires the transferor to notify the transferee of all the rights and obligations in relation to employees that will be transferred in so far as those rights and obligations are or ought to be known to the transferor at the time of transfer. However, a failure by the transferor to notify the transferee of any such rights or obligations does

[118] Retrieved http://ec.europa.eu/employment-social/labour-law/docs/transfer-memorandum-2004-en.pdf
[119] Article 4 (2)
[120] Retrieved http://ec.europa.eu/employment-social/labour-law/docs/transfer-memorandum-2004-en.pdf

not affect the transfer of that right or obligation and the rights of any employee against the transferee and/ or transferor in respect of that right or obligation.[121]

4.1.5.4 Information and consultation

The transferor and transferee are required to inform the representatives of their respective employees affected by the transfer of the following:-

- the date or proposed date of the transfer;
- the reasons for the transfer:
- the legal, economic an social implications of the transfer for the employees; and
- any measures envisaged in relation to the employees.

The transferor must give such information to the representatives of the employee in good time, before the transfer is carried out and before his employees are directly affected by the transfer as regards their working conditions of work and employment.[122] If the employees do not have representatives, they must be informed in advance as in Article 7 (1).[123]

4.1.5.5 Non-entitlement to waive the rights conferred by the Directive

The protection conferred by the Directive is a matter of public policy. An employee cannot waive the rights conferred upon him by the Directive. These rights cannot be restricted, even with his consent, even if the disadvantages resulting from his waiver are offset by such benefits that, taking the matter as a whole, he is not placed in a worse position.[124]

The Directive`s rules apply to all, including the employees' representatives, who may not agree to different arrangements in an agreement with the transferor or the transferee.

It is not permissible to derogate from the rules in a manner unfavourable to the employees, and, hence, the implementation of the rights may not be made subject to the

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[121] Article 3 (2)
[122] Article 7 (1)
[123] Article 6
[124] Retrieved http://ec.europa.eu/employment_social/labour_law_docs/transfer_memorandum_2004_en.pdf

consent of the employee representatives or the employees themselves, with the sole reservation, as regards the workers themselves, that, following a decision freely taken by them, they are at liberty, after the transfer, not to continue the employment relationship with the new employer, in which case their contracts or employment relationships would be regarded as having been terminated either by the employees or the employer depending on the circumstances.[125]

\4.1.5.6 Collective agreements

The Directive compels the transferee to continue to observe the terms and conditions agreed upon in any collective agreement on the same terms applicable to the transferor under that agreement, until the date of termination or expiry of the collective agreement or the entry into force or application of another collective agreement. Further Article 3.3 gives Member States an option to limit the period of observance of terms and conditions but which period shall not be less than one year.[126]

4.1.5.7 Dismissal by reason of a transfer of an undertaking

The transfer of an undertaking, business or part of a business does not in itself constitute grounds for the dismissal by the transferor or transferee but this provision does not stand in the way of dismissals that may take place for economic, technical or organisational reasons entitling change in the workforce.[127] The Directive's scope as far as dismissals are concerned may be curtailed by the right recognized in the Member State, of withdrawing protection from "certain specific categories of employees who are not covered by the laws and practice of the Member States in respect of protection against dismissal".[128]

4.1.6 Application of the provisions of the above articles to insolvency proceedings

Article 5.1 of the Directive provides that unless Member States provide otherwise

[125] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/transfer_memorandum_2004_en.pdf
[126] Article 3 (3)
[127] Article 4 (1)
[128] Article 4 (1) second indent

the normal safeguards for employees contained in articles 3 and 4 of the Directive do not apply where "the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of a competent public authority (which may be an insolvency practitioner authorized by a competent public authority).

Article 5.2 of the Directive gives Member States two new options in cases where its requirements are applied in relation to insolvency proceedings under the supervision of a competent public authority (which may be an insolvency practitioner determined by national law).

These two options are:

- Where, the Member States have made the provisions of article 3, and 4 applicable to their national law, they may provide that notwithstanding the provisions of Article 3(1) the transferor's debts arising from any contract of employment relationship and payable before transfer or before opening of insolvency proceedings shall not be transferred to the transferee; and or alternatively

- The transferee, transferor or persons exercising the transferor' functions, on the one hand, and representatives of employees on the other hand may agree to alterations in so far as current law and practice permits, to employees, terms and conditions of employment opportunities by ensuring the survival of the undertaking or business.

However, the stand point of the Council is that, in cases where the Member States have chosen option one or both, they must make a provision for protection of employees' rights at least equivalent to that provided in situations covered by Council Directive 80/987/EEC of October 1980 on approximation of the laws of Member States relating to protection of employees in the event of the insolvency of their employers.

As compared to our system of transfer of insolvent undertakings, the protection afforded by the Directive to employees in the event of insolvency of their employer is inadequate particularly with regard to protection of employees against dismissals. In

terms of the Directive unless the Member States otherwise provide, the transfer of the undertaking constitute a ground for dismissals in insolvency situations. In terms of the Directive unless the Member States otherwise provide, existing terms and conditions of employment may be altered even if the alteration will not be to the benefit of the employees, but will be to safeguard employment opportunities and ensure the survival of the undertaking. In our law, the transfer of an insolvent undertaking does not constitute a ground for dismissal unless it is for genuine economic, technical or organizational reason entitling changes in the workforce.[129]

However, Article 4 of the Directive requires Member States to take appropriate measures with a view to preventing misuse of insolvency proceedings in such a way as to deprive employees of their rights in the event of a transfer. Generally one can say that Article 5(1) permits Member States to adopt legal regimes which are prima-facie less protective in the event of insolvency of the transferor[130].

4.2 Implementation of Directive 77/187/EEC as amended by Directive 98/50 EC and Consolidated in Directive 2001/23/EC by Member States.

4.2.1 United Kingdom

In the United Kingdom the transfer of undertakings is now regulated under the Tupe Regulations 2006 which revises the previous Tupe Regulations 1981 as amended by Tupe Regulations 1999. The Regulations came into force on the 06 April 2006.[131]

4.2.1.1 The regulations apply to "relevant transfer".

A "relevant transfer" can occur when:-
(a) an undertaking, business or part of an undertaking or business is transferred from one employer to another as a going concern. This can include cases were two companies cease to exist and combine to form one company; and (b) a client engages a contractor to do work on its behalf, or reassigns such a contract including bringing the

[129] Section 187 (1) (g) Ibid. no. 86
[130] Smith N, Employment Protection, Transfer of Undertakings (LLD) Thesis, RAU 2001, p.59
[131] Retrieved http: www.opsi.gov.uk./si/si2006/20060246.htm

work "in house" (a circumstance defined as "service provisioning changes").[132]

4.2.1.2 Business Transfer

To qualify as a business transfer. the regulations do not therefore apply to transfers by share take-overs because, when a company's shares are sold to new shareholders, there is no transfer of business or undertaking. The same company continues to be the employer. Also, the regulations do not ordinarily apply to a transfer of assets, but not employees. So, the sale of equipment alone would not be covered. However the fact that employees are not taken on does not prevent TUPE regulations applying in certain circumstances.[133]

To be covered by the Regulations and for the affected employees to enjoy the rights under them, a business transfer must involve the transfer of an "economic entity which retains its identity". In turn, an "economic entity" means "an organized grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary." [134]

4.2.1.3 Service provision changes [135]

"Service provisioning changes" concern relationship between contractors and the clients who hire their services. Examples include contracts to provide such labour-intensive services as office cleaning, workplace catering. security guarding, and refuse collection and machinery maintenance.[136]

The changes to these contracts can take three principal forms:

- where a service previously undertaken by a client is awarded to a contractor ("a process known as "contracting out" or "out sourcing");[137]

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[132] Regulation 3 (1) (a)
[133] Retrieved http://www.dti.gov.uk/files/file20761pdf
[134] Retrieved http://www.dti.gov.uk/files/file20761pdf
[135] Regulation 3 (1) (b)
[136] Retrieved http://www.dti.gov.uk/files/file20761pdf
[137] Regulation 3 (1) (b) (i)

- where a contract is assigned to a new contractor on subsequent re-tendering;[138] or
- where a contract ends with the service being performed "in house" by a former client ("contracting in" or "insourcing").[139]

4.2.1.4 Organised grouping of employees

The regulations apply only to those changes in service provision which involve "an organized grouping of employees ... which has as its principal purpose the carrying out of the activities concerned on behalf of the client". This is intended to confine the Regulations' coverage to cases where the old provider (that is the transferor) has in place a team of employees to carry out the activities, and that team is essentially dedicated to carrying out the activities that are to be transfered (though they do not need to work exclusively on those activities).[140]

It would therefore exclude cases where there was no identifiable grouping of employees. This is because it would be unclear which employees should transfer in the event of a change of contractor, if there was no such a grouping. So if a contractor was engaged by a client to provide , say a courier service, but the collections and deliveries were carried out each day by various different couriers on an ad hoc basis, rather than by an identifiable team of employees, there would be no "service provision change" and the Regulations would not apply.[141]

A service provisioning change will often capture situations where an existing service contract is re-tendered by the client and awarded to a new contractor. It would also potentially cover situations where just some of those activities in the original service contract are re-tendered and awarded to a new contractor, or where the original service contract is split up into two or more components, each of which is assigned to a different contractor. In each of these cases, the key test is whether an organised grouping has as its principal purpose the carrying out of the activities that are transferred. A grouping of employees can constitute just one person, as may happen,

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[138] Regulation 3 (1) (b) (ii)
[139] Regulation 3 (1) (b) (iii)
[140] Retrieved http://www.dti.gov.uk/files/file20761.pdf
[141] Retrieved http://www.dti.gov.uk/files/file20761.pdf

say, when the cleaning of a small business premises is undertaken by a single person employed by a contractor.[142]

4.2.1.5 The effect of the regulations where employees work outside the United Kingdom

The Regulations may still apply notwithstanding that the persons employed in the undertaking ordinarily work outside the United Kingdom. For example, if there is a transfer of a UK exporting business, the fact that the sales force spends the majority of its working week outside the United Kingdom will not prevent the Regulations applying to the transfer, so long as the undertaking itself (comprising amongst other things, premises, assets, fixtures and fittings, goodwill as well a employees) is situated in the United kingdom.[143]

In the case of provisioning change, the test is whether there is an organized grouping of employees situated in the United Kingdom (immediately before the change). For example, where a contract to provide website maintenance comes to an end and the client wants someone else to take over the contract, if in the organised grouping of employees that has performed the contract, one of the IT technicians works from home, which is outside the United Kingdom, the Regulations will apply to the transfer of the business. However if the whole team of IT technicians work from home which was outside the United Kingdom, then a transfer of the business for which they work would not fall within the Regulations as there would be no organised grouping of employees situated in the United Kingdom.[144]

4.2.1.6 Effects of the Regulations on the employees and contracts of Employment

Employees employed in the "oragnised grouping" immediately before the transfer automatically become employees of the new employer. However, an employee has the right to object to the automatic transfer of his contract of employment if he so wishes, as long as he informs either the transferor or the new employer that he objects to the

[142] Retrieved http://www.dti.gov.uk/files/file20761pdf
[143] Retrieved http://www.dti.gov.uk/files/file20761pdf
[144] Retrieved http://www.dti.gov.uk/files/file20761pdf

transfer of his contract. In that case, the objection terminates the contract of employment and the employee is not treated for any purpose as having been dismissed by either the transferor or the new employer. Moreover the employee is considered to have resigned and would therefore not be entitled to a redundancy payment.[145]

The new employer takes over all rights and obligations arising from contracts of employment except for criminal liabilities and some benefits under an occupational pension scheme.[146] This means that the new employer inherits any outstanding liabilities incurred by the old employer by his failure to observe the terms of those contracts or failure to observe employments rights. So, an employee may bring a claim to court or an employment tribunal against the new employer for, say, breach of contract, injury or discrimination on grounds of sex, even though the breach of contract, injury or discrimination occurred before the transfer took place.[147]

4.2.1.7 Changes to the terms and conditions of employment

The Regulations prohibit variation to terms and conditions of employment where the sole reason for the variation is. the transfer itself or a reason connected with the transfer which is not " an economic, technical or organizational reason entailing changes in the workforce". If contracts are varied for these reasons, then those variations are rendered void by the Regulations.[148]

4.2.1.8 Freedom to vary the terms and conditions of employment

The Regulations provide some freedom for a transferor employer or new employer to agree with an employee to vary an employment contract before or after the transfer. The employer and employee can agree to vary an employment contract where the sole and principal reason is a reason unconnected with the transfer or a reason connected with transfer which is "an economic. technical or organizational reason entailing changes in the workforce".[149] A reason unconnected with the transfer could include the sudden loss

[145] Regulation 4 (1) (7) and (8)
[146] Regulation 4 (2) (a) and (b)
[147] Retrieved http://www.dti.gov.uk/files/file20761.pdf
[148] Regulation 4 (4) (a) and (b)
[149] Regulation 5 (a) and (b)

of an expected order by a manufacturing company or a general upturn in demand for a particular service or change in a key exchange rate.[150]

4.2.1.9 Collective agreements

The new employer takes over the collective agreements made by or on behalf of the transferor employer in respect of any transferring employees and in force immediately before the transfer. The application of these collective agreements in relation to the employees after transfer, have the same effect as if made by or on behalf of the transferee with a trade union. Accordingly anything done under or in connection with them, in their application in relation to the employees, by or in relation to the transferor before the transferor, is deemed to have been done by or in relation to the transferee.[151]

Where the transferor employer recognised an independent trade union (or unions) in respect of some or all of the transferred employees, then the new employer will also be required to recognise that union (or unions) to the same extent after the transfer takes place. However this requirement only applies if the organised grouping of transferred employees maintains an identity distinct from the remainder of the new employer's business. If the undertaking does not keep its separate identity, the previous trade union recognition lapses, and it will then be up to the union and the new employer to renegotiate a new recognition arrangement.[152]

4.2.1.10 Consultation with the affected force

The Regulations place a duty on both the transferor and new employer to inform and consult representative of their employees who may be affected by the transfer or measures taken in connection with the transfer.[153] Long enough before a relevant transfer to enable the employer of any affected employees to consult the appropriate representatives of any affected employees. the employer shall inform those representatives of:-

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[150] Retrieved http://www.dti.gov.uk/files.file20761pdf
[151] Regulation 5 (a) and (b)
[152] Regulation 6 (1) and (2) (a)
[153] Regulation 13

- the fact that the transfer is to take place, the date or proposed date of the transfer and the reasons for it;[154]
- the legal, economic and social implications of the transfer for any affected employees;[155]
- whether the employer envisages taking any action in connection with the transfer which will affect the employees, and if so, what action is envisaged;[156] and
- where the previous employer is required to give the information, he or she must disclose whether the prospective new employer envisages carrying out any action which will affect the employees, and if so, what. The new employer must give the previous employer the necessary information so that the previous employer is able to meet this requirement.[157]

If action is envisaged which will affect the employees, the employer must consult the representatives of the employees affected about that action. The consultation must be undertaken with a view to seeking agreement of the employee representatives to the intended measures.[158] During the consultation the employer must consider and respond to any representations made by the representatives. If the employer rejects these representations he must state the reasons.[159]

4.2.1.11 Disclosure of "employee liability information" to new employer

The transferor employer must provide the new employer with a specified set of information which will assist him to understand the rights, duties and obligations in relation to those employees who will be transferred.[160] The information must be in writing or other forms which are accessible to the new employer.[161] This will help the new employer to prepare for the arrival of the transferred employees, and the employees also gain because their new employer is made aware of his inherited obligations towards them.[162] The information in question includes the following details:-

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[154] Regulation 13 (2) (a)
[155] Regulation 13 (2) (b)
[156] Regulation 13 (2) (c)
[157] Regulation 13 (2) (d)
[158] Regulation 13 (6)
[159] Regulation 13 (7) (a) and (b)
[160] Regulation 11 (1)
[161] Regulation 11 (1) (a) and (b)
[162] Retrieved http://www.dti.gov.uk/files/file20761.pdf

- the identity and ages of the employees who will transfer;[163]
- the particulars of employment of the employees;[164]
- Instances of any disciplinary action within the preceding two years taken by the transferor in respect of those employees in circumstances where dispute resolution mechanism applied;[165]
- Instances of any legal actions taken by those employees against the transferor in the previous two years, and instances of potential legal actions which may be brought by those employees where the transferor has reasonable grounds to believe that such actions might occur;[166]
- Information of any collective agreement which will have effect after transfer, in its application in relation to the employees.[167]

The duty to provide employee liability information includes the duty to provide employee liability information of an employee who had been unfairly dismissed due to the relevant transfer.[168]

This information must be given at least fourteen days before the completion of the transfer. However, if special circumstances make this not reasonably practicable, the information must be supplied as soon as it is reasonably possible.[169] Failure to provide employee liability information is actionable and the transferee may be warded compensation in an amount of five hundred pounds per employee in respect of whom the transferor has failed to comply with the provisions of Regulation 11.

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4.2.1.12 The position of employees of the insolvent undertaking

If at the time of a relevant transfer the transferor is subject to insolvency proceedings, the regulations ensure that some of the transferor's pre-existing debts to the employees do not pass to the new employer.[170] Those debts concern any obligations to pay the employees statutory redundancy pay or sums representing various debts to them such as

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[163] Regulation 11 (2) (a)
[164] Regulation 11 (2) (b)
[165] Regulation 11 (2) (c) (i) and (ii)
[166] Regulation 11 (2) (d) (i) and (ii)
[167] Regulation 11 (2) (e)
[168] Regulation 11 (4)
[169] Regulation 11 (6)
[170] Regulation 8 (7)

arrears of pay in lieu of notice, holiday pay or a basic award of compensation for unfair dismissal. Payment of statutory redundancy pay and the other debts are met by the Secretary of State through the National Insurance Fund. However, any debts over and above those that can be met in this way will pass across to the new employer.[171]

If at the time of a relevant transfer the transferor is subject to relevant insolvency proceedings, the Regulations provide greater scope for the new employer to vary the terms and conditions of employment of the affected employees after transfer. Essentially the Regulations place significant restrictions on the variation of contracts of employment because of the transfer or a reason connected with the transfer. These restrictions are waived, allowing the transferor, the new employer or the insolvency practitioner to reduce pay and establish other inferior terms and conditions of employment after the transfer.[172] However, in their place, the regulations impose other conditions on the new employer when varying contracts.

The conditions are as follows:-

- the transferor, new employer or insolvency practitioner must agree to the "permitted variation" with representatives of the employees;[173]
- the representatives must be union representatives where an independent trade union is recognized for collective bargaining purposes by the employer in respect of any of the affected employees. Those union representatives and the transferor, new employer or insolvency practitioner are then free to agree variations to the contracts;[174]
- in other cases, non-union representatives are empowered to agree to the permitted variations with the transferor, new employer or insolvency practitioner. However, where agreements are reached by non-union representatives, two other requirements must be met. First, the agreement which records the permitted variation must be in writing and signed by each of the non-union representatives. Secondly before the agreement is signed, the employer must provide all the affected employees with a copy of the agreement

[171] Retrieved http://www.dti.gov.uk/files/file20761pdf
[172] Retrieved http://www.dti.gov.uk/files/file20761pdf
[173] Retrieved http://www.dti.gov.uk/files/file20761pfd
[174] Retrieved http://www.dti.gov.uk/files/file20761pdf

and any guidance the employees would reasonably need in order to understand it;[175]

- the new terms and conditions agreed in a "permitted variation, must not breach other statutory entitlements. For example any agreed pay rates must not must not be set below the national minimum wage);[176] and

- a "permitted variation" must be made with the intention of safeguarding employment opportunities by ensuring the survival of the undertaking or business.

4.2.2 Federal Republic of Germany

In Germany the transfers of undertakings are regulated under section 613(a) of the Civil Code (Burgerliches Gesetzbuch (BGB).This section implements the provisions of Directive 77/187/ECC as amended by Directive 2001/23/EC.[177] Section 613a applies to:[178] (a) the transfer of an undertaking or part of an undertaking which is an economic entity and retains its identity irrespective of the transfer; and (b) on a service provisioning change (contracting out or in-house of activities; changing contractors) which is connected with the transfer of assets and/or staff.

4.2.2.1Transfer

The legislation does not define the meaning of transfer, it merely refers to the transfer of an economic entity by legal transaction to another owner.[179] A further prerequisite relates to the quality of an undertaking. A transfer of an undertaking will only occur if an economic entity is transferred. An entity is designated by an organized group of persons and assets facilitating the exercise of an economic activity which aims to achieve a specific objective.[180] A part of an undertaking may be considered an economic entity as well. To be subject to the legislation it must be an autonomous

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[175] Retrieved http://www.dti.gov.files/file20761pdf
[176] Retrieved http://www.dti.gov.files/file20761pdf
[177] Retrieved http://employment-news.lovells.de/download Business-Transfer-across-Europe.pdf
[178] Retrieved http://www.iuslaboris.com pdf ToUMarch2007.pdf
[179] Section 613a (1)
[180] Retrieved http://www.iuslaboris.com pdf TofUMarch2007.pdf

entity, organized so as to be detachable, which only performs particular labour-specific functions within the business as a whole.[181]

This economic entity must retain its identity irrespective of the transfer. If the essential means of operations which are necessary to effectively manage the business are transferred to the purchaser and the activities can be carried on in the same way, a transfer within the meaning of the legislation has taken place. Upon the sale of an establishment including all tangible and intangible assets and staff the entity definitely retains its identity. In other circumstances it must be assessed on a case-by-case basis whether there is relevant transfer. One must consider which decisive facts represent the entity and whether a meaningful continuation of the undertaking is possible with the business means or staff taken over.[182]

The European Court of Justice has developed the following guidelines in evaluating the identity of a transferred business:-[183]

The type of business;

- The transfer of tangible assets such as buildings, machines, etc. and their value and significance to the undertaking;
- The transfer of intangible assets, for example, patent and utility model rights and their value;
- The duration of any interruption in the business operations;
- The similarity between the activities;
- The retention of the majority of employees; and
- The adoption of customer and supplier relationships.

A distinction has to be made between a manufacturing company and a service provider. In as much as a service provider is affected, a takeover of most of the staff (engaged in a joint activity on a permanent basis) and a succession in the activities are indicative factors of a transfer of an undertaking. In the case of a manufacturing company, for example, there would not be a transfer if only certain equipment and the machinery and tools for an in-house repair shop were transferred. Yet the transfer of equipment (and

[181] Retrieved http://www.uislaboris.com/pdf/TofUMarch2007.pdf
[182] Retrieved http://www.uislaboris.com/pdf/TofUMarch2007.pdf
[183] Retrieved http://www.iuslaboris.com/pdf/TofUMarch2007.pdf

not employees taken over) might also be crucial on a service provisioning change if the equipment is essential and indispensable with a view to the performance of the activity.[184]

The acquisition of an insolvent business also falls within section 613a. Therefore if the insolvency trustee or practitioner sells the operations, the purchaser has to assume staff and liabilities.[185]

4.2.2.2 The effect of transfer

4.2.2.2.1 Impact of transfer under individual labour law

Employment relationships existing at the time of the transfer of business will pass, together with all rights and obligations from the transferor to the transferee.[186] All terms of employment continue to apply regardless of whether they arise from individual agreements, standard employment contracts, unilateral stipulation by the employer, company practice or on the basis of principle of equal treatment of employees. Continuity of employment is preserved and employees' length of service under transferee will incorporate time worked for the transferor. These legal consequences cannot be excluded by the parties to the employment relationship prior to the transfer of the business. any agreement purporting to do so will be null and void.[187]

Any attempt to terminate the contract by reason of the transfer is prohibited.[188] However, termination on account of economic, technical or organisational reasons is permissible. These provisions cover all employment relationships existing at the time of the transfer of the business. An individual employment relationship is not transferred if the employee in question objects to such transfer by exercising a right granted to him by statute. This right of objection expires one month after sufficient written information about the transfer of ownership is given to employees.

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[184] Retrieved http://www.iuslaboris.com pdf TofUMarch2007pdf
[185] Retrieved http://employment-news.lovells.de/downlaod Business-transfer-across-Europepdf
[186] Section 613a para 1 sentence 1
[187] Retrieved http://employment-news.lovells.de.download business-Transfer-across-Europepdf
[188] Section 613a (4)

Section 613a does not apply to director's service agreements.[189]

4.2.2.2.2 Impact of transfer under collective labour law

Existing works council agreements and collective agreements continue to apply. If, on transfer, the identity of the business is not retained, the terms of collective agreements continue to be valid only on individual basis. They may not be amended for a period of one year. Within this period, any unilateral or mutually agreed amendment of the terms of the agreement to the detriment of the employee is prohibited, although amendments which are favourable to the employee are permitted.[190]

4.2.2.2.3 Liability of the transferor and transferee

As a rule the transferee is liable for all claims arising out of the employment relationship being transferred. This rule covers the claims which have already arisen by the time of transfer of business, even though the value of the work performed itself benefits the transferor. The liability includes not only claims for wages or salary, but also any pension liabilities. The transferee must assume all pension liabilities of the transferor and must fulfil the pension obligations of the transferor when they fall due, irrespective of whether parts of the pension obligations had been accrued and vested during the term that the employee beneficiary had worked for the transferor.[191]

The transferor and transferee are jointly and severally liable for obligations which arose prior to the transfer of the business and fall due within one year of such transfer. Although the transferee is liable for such claims only on a pro rata basis.[192] Employees can nevertheless demand that the transferee fulfils these claims in full. The transferee will have recourse against the transferor for a proportion of the compensation made.[193]

4.2.2.3 The effect of transfer on employees

Provided all of the undertaking is acquired, all individuals employed in the undertaking

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[189] Retrieved http://employment-news.lovells.de.download/business-Transfer-across.Europepdf
[190] Section 613a para 1 sentence 2 to 4
[191] Retrieved http://employment.news.lovells.de/download/Business-Transfer-across.Europepdf
[192] Section 613a para 2 sentence 2
[193] Retrieved http://employment.news.lovells.de/download/Business-Transfer-across.Europepdf

are transferred to the transferee by operation of law, except any secion of the workforce employed in a branch or department due to be closed down by the transferor on account of the planned transfer. This part of the workforce would have to be made redundant. If only part of the undertaking is transferred, only the staff who are employed in that section will be transferred.[194]

The transfer of employees by operation of law does not require consent of the transferor, transferee or the employees. The employees, however, may raise objection to the automatic transfer, if they have knowledge of that transfer. Otherwise if they are only notified of the transfer after it has occurred, the employee may still insist (within reasonable limits) on being released and continuing their jobs with the old employer. This makes it necessary as a matter of practice for the transferee to seek and obtain, prior to the transfer, the approval of the employees. Pension obligations relating to former employees do not transfer to the transferee, but do transfer in relation to transferring employees.[195] However, if the transferee acquires the business from an insolvency trustee after the commencement of the insolvency procedure, the transferee is not liable fro pension obligations for periods before the start of the insolvency procedure.[196]

Whether (and if so, how) obligations arising from share option schemes are transferred to the transferee is the subject of debate. So far, the Federal Labour Court has held that they will not be transferred if the share option programme was introduced by another legal entity and this other legal entity was the obligator with regard to the duties arising from the share option programme.[197]

4.2.2.4 Consultation

Where a transfer of assets amounts to a transfer of the whole business, the employees engaged in that business are automatically transferred by operation of law to the purchaser. The employees, however, have the right to object and to refuse to transfer,

[194] Retrieved http://employment-news.lovells.de/download/Business-Transfers-across.Europepdf
[195] Retrieved http://employment-news.lovells.de/download/Business-Transfers-across-Europepdf
[196] Retrieved http://employment-news.lovells.de/download/Business-Transfers-across-Europepdf
[197] Retrieved http://employment-news.lovells.de/download/Business-Transfers-across-Europepdf

with the result that those employees refusing to transfer to the transferee remain employees of the transferor.[198]

In order to enable the employees to asses whether they want to be transferred to the transferee or to stay with the transferor, German statutory labour law provides that one of the parties has to notify the employees affected by the transfer(the responsibility for doing so should be agreed and recorded in the sale agreement) properly and comprehensively about:-[199]

- the date or the intended date of the transfer of business;
- the reason for transfer;
- the legal, commercial and social consequences of the transfer for the employees; and
- Any actions intended to be taken with regard to employees.

Each employee has the right to object to the transfer of his employment to the purchaser within one month following receipt of the proper notice. The one month period only starts to run if the notice was provided properly, that is, in the right format with the correct and comprehensive content.

4.2.2.5 Unfair dismissals

The dismissal of an employee by reason of a business transfer in null and void. However termination of employment based on grounds other than the transfer of a business remains legal. Apart from personal grounds or poor performance, a dismissal may also be justified on the grounds of operational changes. However the burden of proof for establishing the real motive will be with the employer if the validity of the dismissal is disputed by the employee in the labour court. Therefore the employer will have to establish that reasons other than the transfer itself motivated the dismissal. Dismissal could, for example, be justified if, in the case of transfer, it had a clear restructuring concept for the acquired business.[200]

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[198] Retrieved http://employment-news.lovells.de/download/Business-Transfers-across-Europepdf
[199] Retrieved http://employment-news-lovells.de/download/Business-Transfers-across-Europepdf
[200] Retrieved http://employment-news.lovells.de.download/Business-Transfers-across-Europepdf

4.3 Insolvency Directive 80/987/EEC as Amended by Directive 2002/74/EC

Directive 80/987/ECC is a European Community instrument aimed at providing a minimum degree of protection to the employees in the event of insolvency of their employer. It was amended to take into account of the changes in insolvency law in the Member States, the development of internal markets with growing numbers of undertakings with cross-border dimensions, other Community Directives related to employment law and established case law of the Court of Justice in this area.[201]

4.3.1 The Material and Personal Scope of the Directive

According to Article 1(1) the Dirctive applies to employees' claims arising from contracts of employment or employment relationships and existing against employers who are in a state of insolvency within the meaning of Article 2(1).

According to Article 2(1), an employer is considered to be in a state of insolvency where a request has been made for the opening of collective proceedings based on insolvency of the employer, as provided for under the laws, regulations and administrative provisions of a Member State, and involving partial or total divestment of the employer's assets and the appointment of a liquidator or a person performing a similar task, and the authority which is competent pursuant to the said provisions has:

- either decided to open proceedings; or
- established that the employer's undertaking or business has been definitively closed down and that the available assets are insufficient to warrant the opening of the proceedings.

The present wording of the definition of the Insolvency Directive 80/987/ECC is not precisely the same as the original one. The definition of state of insolvency has been amended to include, within its meaning, insolvency proceedings other than liquidation. Insolvency proceedings commencing as restructuring, reorganization partial closure of the undertaking will now be treated as single insolvency proceedings. Employees whose

[201] Retrieved http://www.europarl.eu.int/oeil/findbyprocnum.do?lang=en&procnum=CDO10006

rights have been adversely affected under these proceedings will now be able to claim from the benefits provided by guarantee institutions.

The scope and application of the Directive has also been extended to employees pursuing their activities in a number of Member States. To this end a provision has been included in the text of the Directive, which expressly states which institution is responsible for meeting the outstanding claim of the workers, the institution responsible is that in the Member State in whose territory the workers concerned work or habitually work. Where an undertaking with activities in the territories of at least two Member States is in a state of insolvency, the institution responsible for meeting employees' outstanding claims is that in the Member State in whose territory they work or habitually work. The extent of employees' rights is determined by the law governing the competent institution[202].

Before the Directive was amended, Article 1(2) thereof excluded two categories of employees from its scope. First, employees could be excluded by virtue of the "special nature" of employees' contract of employment. Secondly, employees could be excluded from the protection of the Directive because of the existence of other forms of guarantee which offered employeea protection equivalent to that conferred by the Directive. Since its amendment, it stipulates that Member States may not exclude from its scope of application, part-time employees, workers with fixed term contracts or workers with temporary employment relationships.[203] Further Member States may not set a minimum duration for contract of employment or the employment relationship in order for the worker to qualify for claims under the Directive.

The second exclusionary rule is still retained in the Directive but it must be by way of exception. However paragraph 3 of Article 1 provides that where such a provision already applies, a Member State may continue to exclude from the scope of the Directive (a) Domestic servants employed by a natural person; (b) Share fishermen. The implication is that where these categories of employees have previously not been expressly excluded from the scope of the Directive, they may not now be excluded under the amended Directive[204].

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[202] para 7 to the recital and section III (a) of the Directive
[203] Article 2 (2) (a) (b) (c)
[204] Article 2(2) (a)(b)(c) and section 1 Article 1(2) and (3)

4.3.2 Protection conferred by the Directive

The Directive obliges Member States to take measures necessary to ensure that guarantee institutions guarantee, subject to limitations in Article 4, payment of employees' outstanding claims resulting from contracts of employment or employment relationships, including, where provided for by national law severance pay on termination of employment relationship.[205] Secondly, it obliges Member States to take measures necessary to ensure that the non-payment of compulsory contributions due from the employer, before the onset of his insolvency, to their insurance institutions under national social security schemes does not adversely affect employees' benefit entitlement in respect of these insurance institutions inasmuch as the employees' contributions were deducted at source from the remuneration paid.[206]

4.3.3 Payment by Guarantee Institution of Employees Claims

The Directive gives Member States an option to limit the liability of the guarantee institution[207] but where a Member State chooses to exercise this option it must specify the length of the period for which outstanding claims are to be met by the guarantee institution which period may not be shorter than a period covering the remuneration of at least three months of the employment relationship prior to and/ or after the date determined by the Member State. The Member States may include this minimum period of three months to a contract of employment with a duration of not less than six months.[208]

Member States having a reference period of not less than eighteen months for which outstanding claims are to be met by guarantee institution may limit this period to eight weeks. However, those periods which are most favourable to the employees are to be used for the calculation of the minimum period. The Directive permits Member States to set ceilings on the payments made by the guarantee institution. However, these ceilings must not fall below a level which is socially compatible with the social objective of the Directive. The Directive obliges Member States to inform the

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[205] Article 3.2
[206] Article 7 and 8
[207] Article 4
[208] Article 4.2

Commissioner of the method used to set the ceiling[209].In order to facilitate the proper application of the Directive in insolvency proceedings with cross border dimensions, the Directive obliges Member States to make a provision for the sharing of relevant information between their competent administrative authorities and/ or the guarantee institutions so as to make it possible to determine in a given situation as to which guarantee institution is responsible to meet the claims of the employees[210].

Article 2 of the final provisions enjoins Member States to bring into force the laws, regulations and administrative provisions necessary to comply with the provisions of the Directive the cut off date of which was 08 October 2005. In terms of Article 10 Member States may take measures necessary to avoid abuses.

4.4 Implementation of the Directive by Member States[211]

Upon its adoption, Directive 80/987 was super imposed on a number of national provisions already in force in Belgium (1967), the Federal Republic of Germany (1974), France (1973), the United Kingdom (1975), Luxemburg (1977), and the Netherlands (1968). Portugal and Spain, although at that time not members of European Communities, had also enacted legislation in this field. In other member states – Greece (1981), Ireland (1984) and Italy – Directive 80/987 formed the basis for national provisions governing the financial protection of employees, in the event of insolvency of their employers, going beyond the general priority accorded to employees' claims in the event of bankruptcy.[212]

Because of these factors and different insolvency law obtaining in the Member States, the provisions regarding guarantee institutions differ from one Member State to another Member State.

The differences can be attributed mainly to different definitions of concepts such as employer, employee, employment relationship, insolvency etc. The effect of these

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[209] Article 4 (1) (2) and (3)
[210] Article 8 (b)
[211] Retrieved http://ec.euproa.eu/employment-social/labour-law/docs/02-insolvent-imp/report-en.pdf
[212] Retrieved http://ac.europa.eu/employment-social/labour-law/docs/02-insolvent-imp/report-en.pdf

definitions is that they either limit or extend coverage of insolvency protection. Although limitations on coverage do not accord with the spirit and social objective of the Directive, what is important is that the claims of the employees who are covered are guaranteed in the event of insolvency of their employer. However, it must be emphasized that the European Courts are not in favour of exclusions of certain categories of employees and limitations of insolvency protection. Mention needs to be made of the fact that some of the Member States did not specifically limit categories of persons covered by the protection against effects of insolvency when transposing the provisions of the Directive into national laws. for instance, Belgium, France, Federal Republic of Germany, Denmark and Luxemburg.[213]

Two Member States will be considered hereunder to illustrate the implementation of the Directive.

4.4.1 The concept of employer

Article 1 (1) makes its application dependent upon the employer being insolvent. Article 2 (2) leaves it up to each Member state to define who is an "employer". The making use of a definition designed specifically to limit guarantee payments is not permissible. National legislation may give only a general definition of the term "employer". In contrast to the term "employee", Article 1(2) of the Directive does not permit exclusion of certain categories of employer from the scope of the Directive. An annex to the Directive allows this to be done for certain categories of employees only. Therefore, all private and public-sector employers who can suffer insolvency are covered.[214]

4.4.1.1 Federal Republic of Germany

The Federal Republic of Germany has no legal definition of an employer. The general view is that an employer is someone who employs at least one employee. Articles 141a et. seq. of the Arbeitsforderungsgesetz (AFG. or Employment Promotion Act) do not limit the group of employers to which these provisions apply.[215]

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[213] Retrieved http://ac.europa.eu/employment-social/labour-law/docs/02-insolvent-imp-report-en.pdf
[214] Retrieved http://ac.europa.eu/employment-social/labour-law/docs/02-insolvent-imp-report-en.pdf
[215] Retrieved http://ac.europa.eu/employment-social/labour-law/docs/02-insolvent-imp-report-en.pdf

4.4.1.2 United Kingdom

Section 153 (1) of the Employment Protection (Consolidated) Act 1978 states: "Employer in relation to employee, means the person by whom the employee is (or in the case where employment has ceased) was employed. This applies not only toinsolvency protection provisions but to the entire field of application of the Employment Protection (Consolidated) Act.[216]

4.4.2 The concept of employee

In terms of Article 1 (1) of the Directive, only an employee may benefit from the scheme. Under Article 2 (2) Member States determine who qualifies as an employee. However, the Directive has some influence on the transposal to the extent that it allows certain categories of people, who qualify as employees in the national context, to be excluded from the relevant national provisions, provided that those people are covered by other forms of guarantee which offers a degree of protection equivalent to that resulting from the Directive.[217]

As regards entitlement to benefit from the guarantee, the spirit of the scheme forbids examination of whether a person still qualifies or not as an employee when exercising the right in question. The sole determining factor is that the claimant was an employee at the time the entitlement arose.

The continued existence of an employment contract or employment relationship after that point in time is irrelevant.[218]

4.4.2.1 Federal Republic of Germany

The Federal Republic of Germany has no legal definition of the term employee.

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[216] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf
[217] Retrieved http://ec.europa.eu.employment_social/labour_law/docs/02_insolvent_imp/report_en.pfd
[218] Retrieved http://ec.europa.eu.employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf

However, trainees and those working at home are protected by the provisions on the payments for wage loss in the event of bankruptcy under Articles 141a et seq. of the Arbeitsforderungsgesetz(AFG, or Employment Promotion Act). As far as company old-age pension schemes are concerned, Article 17 (1) (2) of the Gesetz zur Verbesserung der betrieblicen Altersversorgung (betrAVG, Law on Improvement of Occupational Retirement Pensions) of 19 December 1974 extends the scope of the law to cover persons who are not employees. Such an extension of protection against insolvency to other persons does not infringe the Directive.[219]

4.4.2.2 United Kingdom

The term "employee" for the purpose of protection in the event of insolvency is defined in section 153 (1) of the Employment Protection (Consolidated) Act 1978. This definition is used generally in the Employment Protection (Conslidated) Act 1978, which covers a very wide range of individual employment rights, and is not limited to insolvency. There is therefore no specific limitation of the term "employee" with regard to protection against insolvency.[220]

However, the Employment Protection (Consolidated) Act expressly excludes some categories of workers from protection against insolvency namely the crews and masters of fishing vessels "where an employee is remunerated only by share in profits or gross earnings of the vessel". Exclusion of the masters and crews of fishing vessels under section 144(2) is permitted under Article 1(2) of the Directive. Such workers are considered to be self-employed partners in the venture.[221]

4.4.3 Claims arising from contracts of Employment and Employment Relationship.

4.4.3.1 Federal Republic of Germany

Article 141B (1) of the Arbeitsforderungsgesetz (AFG or Employment Promotion Act) uses only the term Arbeitsverhältnis (employment relationship). This covers both a

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[219] Retrieved http://ec.europa.eu/employment-social/labour-law/docs/02-insolvent-imp/report.en.pdf
[220] Retrieved http://ec.europa.eu/employment-social/labour-law/docs/02-insolvent-imp-report-en.pdf
[221] Retrieved http://ec.europa.eu/employment-social/labour-law/docs/02-insolvent-imp-report-en.pdf

contractual employment relationship and employment relationship which has no legal basis. The guarantee covers Ansprücheauf Arbeitsentgelt (claims for payment for work).[222] In a broadest sense, this means all money payments and payments rendered in kind arising from employment relationship and which an employee receives on account of an employment contract or a de facto employment relationship.[223]

4.4.3.2 United Kingdom

British law adopts an enumeration principle. Section 122(2) of the Employment Protection (Consolidation) Act 1978 introduced a guarantee scheme covering the following claims: arrears of pay not exceeding eight weeks; payment for a minimum notice due on dismissal under s 49(1) or resignation under s 49(2); holiday pay for a maximum period of six weeks; basic awards of compensation for unfair dismissal under section 72 of the Employment Protection (Consolidation) Act and "any reasonable sum by way of reimbursement of the whole or part of any fee or premium paid by an apprentice or articled clerk". Under separate provisions of the 1978 Act (s 106), the United Kingdom also guarantees payment on employer insolvency, of any statutory redundancy payment due to the employee. Section 153(1) of the Employment Protection (Consolidation) Act requires categorically that the employee must have a contract of employment. Section 153 of the 1978 Act, states that "contract of employment" means a contract of service or apprenticeship, whether expressly or implied, or whether it is oral or in writing. "Atypical" workers are also covered in this concept.[224].

4.4.4. Temporal Limitation of Guarantee Payments

4.4.4.1 Federal Republic of Germany

With regard to Article 4(2) first alternative of the Directive, Article 141(b)(1) of the AFG limits the guaranteed claims to the last three months of employment relationship (which includes employment contracts) provided these precede the opening of bankruptcy proceedings or an equivalent event.

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[222] Article 141b(1) of AFG, Article 59 (1) (j) (a) of the Bankruptcy Code
[223] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf
[224] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf

These last three months of employment relationship need not fall within a certain period of time prior to the insolvency event.[225]

4.4.4.2 United Kingdom

Limits payment to eight weeks.[226]

4.4.5 Ceilings for Guarantee Payments

4.4.5.1 Federal Republic of Germany

Germany law sets no ceiling on guarantee payments. Article 7(3) of the BetrAV9 sets the ceiling only in the case of existing payments under company old age pension schemes, something not directly covered by Article 4(3) of the Directive.

4.4.5.2 United Kingdom

Presently the payment by individual guarantee is set at £210 per week. The limit is reviewed each year. However the maximum is subject to reduction if the employee earns from another source or receives unemployment or other state benefits during the period of notice.[227]

4.4.6 "Guarantee" Covering Outstanding Employees' Contributions to Statutory Social Security Schemes deducted by the Employer.

Both in Germany and the United Kingdom employees are entitled to benefit under national statutory social security schemes regardless of whether their contributions have been remitted by an employer. The payments are not dependent on the contributions of employees.

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[225] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf
[226] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf
[227] Retrieved http://www.insolvency.gov.uk/freedomofinformation/technical/techmanvol1/Ch73-84

4.4.7 Guarantee Concerning Immediate or Prospective Entitlements to Benefit under Private Supplementary Old Age Insurance Schemes.

Parallel to the statutory old age pension schemes, many Member States have voluntary company or inter-company schemes (i.e. supplementary occupational schemes). Article 8 obliges Member States to make sure that supplementary insurance bodies can meet their obligations at any time regarding old-age benefits, including those for survivors. This therefore involves regulations which the state must, in implementing the Directive, adopt with regard to the private sector for group insurance, mutual arrangements and supplementary insurance schemes in order for example, to guarantee benefits in the long term. In contrast to Article 7, Article 8 does not oblige Member States to ensure that non payment of contributions by an insolvent employer does not adversely affect the entitlement of the employees. However, despite the omission of this principle, Article 8 imposes a duty upon Member States to see to it that the interests of the employees are protected.[228]

4.4.7.1 Federal Republic of Germany

In Germany the law on Improvement of Occupational Retirement Pensions (BetrAVG) of 1974 specifies four different types of occupational pension insurance; Direktzusage (direct promise of pension provision made by the employer); Employee life insurance, Pensionskasse (pension fund), and Unterstützungskasse (Provident Fund). Insolvency protection for immediate and prospective entitlement is required only when the risk of insolvency exists in cases where benefits are to be provided by an employer himself or by a provident fund financially dependent on the employer. The assets of a pensionskasse, which take the legal form of a mutual insurance body, are not affected by the employer's bankruptcy. A pensionskasse is unlikely to become insolvent and thus unable to pay its debts because (a) it is overseen by supervisory authorities and (b) must ensure on actuarial basis that its liabilities can be financed. Similarly, direct life insurance does not entail any insolvency risk for the employee (for the same reason).[229]

The situation is different, however, for Direktzusage and promises to be met by an Unterstützungskasse. In accordance with Article 1(1) and 4 of BetrAVG, in the event

[228] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf
[229] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf

of employer insolvency inexpirable prospective entitlements are guaranteed by the pensionssichenrungsrerein in accordance with Article 7(2)(1) and 2 of the BetrAVG. Once the benefit falls due, this association pays the benefit in question to the assured or the person entitled under him. Similarly, current benefits being paid to employees are also provided by the pensionssicherungsverein under Article 7(1)(1) and 791)(2) of the BetrAVG. The German provisions therefore fully comply with Article 8 of the Directive.[230]

4.4.7.2 United Kingdom

Two main types of provision exist namely, those providing for the payment of outstanding amounts not paid by an insolvent employer into the supplementary pension scheme and those providing for payment of pension scheme contributions into independent trusts, thus making the pension funds inaccessible to the employers' other creditors.

- Under category 1, the Employment Protection (Consolidation) Act 1978 empowers the Secretary of State to pay contributions out of the National Insurance Fund (a government fund and guarantee Institution), in the event of employer's insolvency and failure to pay contributions. The payment made by the Fund covers contributions deducted by the employer from the pay of the employee, but not put into the resources of the pension scheme, during the 12 months prior to the insolvency. The contributions which the employer is required to make on his own account are also covered.

- Under the trust system the funds earmarked for payment of pensions do not belong to the employer but to trustees administering the retirement schemes, who are obliged by law to act with prudence and in the beneficiaries' interest. They are forbidden to make a profit from trust's assets. If a conflict of interest arises, the trustee must seek outside advice, if necessary from the courts. Further trust assets must not be accessible to satisfy third parties' claims. The assets required to cover pension rights may not be used to cover the personal debts or obligations of the trustee or employer.

[230] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf

4.4.8 Interpretation of the Directive by the courts

4.4.8.1 Necessary measures to avoid abuses

In the case of Ulf Samuelsson v State of Sweden, the plaintiff, Ulf Samuelnon[231], was an employee at Noréns Elektriska: iÄtran Aktiebolag. The company went bankrupt in February 1993. He was paid his outstanding claims in terms of the Wage Guarantee Act in March 1993. The bankrupt company was taken over by another company, which later changed its company name to Nya Norens elektriska: Aktiebolag. The plaintiff continued to work for the company when it was taken over by another company. This company also went bankrupt. The plaintiff lodged a claim against the Guarantee Institution.[232]

According to Swedish law the decision whether to pay wage guarantee lies with the trustee in bankruptcy. On 29 September 1994 the trustee in bankruptcy rejected the claim of the plaintiff in its entirety. The rejection was based on section 9(a) of the Wage Guarantee Act 1992:494, which provides that an employee, who within two years after the bankruptcy decision, was granted remuneration through the guarantee for a claim which arose in mainly the same activity, is not entitled for further remuneration through the guarantee. The guarantee is however applicable, if a public employment office assigned the employee the employment in which the claim at issue arose.[233]

On review the plaintiff submitted that the provision of section 9(a) of the Act are contrary to Council Directive 80/987/EEC on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer, as amended by Directive 87/164/EEC. The review court (district court according to Swedish law) referred the matter to EFTA Court to give an advisory opinion on the interpretation of Article 10 of the Directive. Article 10 of the Directive read as follows:

- "The Directive shall not affect the option of Member States:
- to take measures necessary to avoid abuses;

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[231] Retrieved http://www.eftacourt.lu.default.asp?layout=article&id=29
[232] Retrieved http://www.eftacourt.lu.default.asp?layout=article&id=29
[233] Retrieved http://www.eftacourt.lu.default.asp?layout=article&id=29

- to refuse or reduce the liability referred to in Article 3 or guarantee obligation referred to in Article 7 if it appears that fulfilment of the obligation is unjustifiable because of the existence of special links between the employee and the employer and of common interest resulting in collusion between them."

The advisory opinion sought by the District Court was – "is Article 10(a) of the Directive to be interpreted in such away that section 9(a) of the Swedish Wage Guarantee Act, having regard to its general scope, clearly exceeds the right of derogation permitted by article 10(a)"?[234]

The Government of Sweden invited the Court to refuse to answer the question referred to it because an interpretation of Article 10(a) of the Directive 80/987/EEC could be usefully applied by the requesting court (review court). According to the Government of Sweden, the rule in section 9(a), first paragraph, of the Wage Guarantee Act was clear and precise. Thus there was no room in the provision for any degree of interpretation departing from its clear wording. Even if the legislation were to constitute an incorrect implementation, such an interpretation of the Directive could not be applied by the district court in order to set aside clear and precise national legislation.[235] Further the Government of Sweden at the hearing as well as the state of Sweden in its written observations submitted that the provision of section 9(a) of the Wage Guarantee Act ..... was in fact a measure designed to avoid abuses. The main reason behind it was to hinder distortion of competition.

The court, taking into account the social objective of the Directive and the nature of Article 10(a) as an exception, found that the option to take measures to avoid abuses could not be interpreted as generally permitting any kind of measure which could assist in preventing abuses of the system.

As with all provisions under which a state could adopt measures which derogate from the main principle of the Directive, Article 10 had to be given restrictive interpretation, and any measures undertaken on the basis thereon had to be effective and proportionate. This approach was furthermore supported by the wording of Article 10(a) which provided that such measures must be "necessary to avoid abuses". In such

[234] Retrieved http://www.eftacourt.lu/default.asp?layout=article&id=29
[235] Retrieved http://www.eftacourt.lu/default.asp?layout=article&id=29

circumstances it must be the State which made a derogation that carried the burden of justifying the measures taken. The absence in the version in Swedish of article 10(a) of the word "necessary' could not give rise to any different interpretation.

No convincing evidence had been presented to support the assertion that the aim of preventing abuses necessitated an employee, irrespective of the circumstances in individual cases who, within the previous two years had benefited from a guarantee for a claim which had arisen in mainly the same activity, being refused a second payment under the guarantee. Nor had it been shown that this aim could not be achieved as efficiently through measures which would encroach to a lesser degree upon the rights granted by the Directive to the social protection of the employees.[236]

Article 10(a) of the Directive had to be interpreted as precluding the application, a measure against abuse, of a provision of national law according to which an employee was not entitled to remuneration if, within two years prior to the bankruptcy decision, he was granted remuneration through the guarantee for a wage claim which arose in mainly in the same activity.[237]

4.4.8.2 Exclusion of certain categories of employees

In the Spanish case of Teodoro Wagner Miret v Fondo de Garantia Salarial,[238] the plaintiff, Mr Wagner Miret, was dismissed under a "redundancy" procedure authorized on 24 November 1989 by the head of the Local Labour Department of the Autonomous Community of Catalonia after the company was declared insolvent. He brought an action before the Juzgado de lo Social No 27, Barcelona, to recover the unpaid salary for October and November 1989 and for the appropriate severance payments. His application was dismissed on the ground that he had been a member of higher management staff. He appealed against this judgment in the Tribunal Superior de Justicia, Catalonia. The Tribunal Superior de Justicia referred this matter to the European Court of Justice for a ruling. Prior to its accession to the European Communities, the Kingdom of Spain established a guarantee fund which excluded higher management staff from its application. After its accession to the European

[236] Retrieved http://www.eftacourt.lu/default.asp?layout=article&id=29
[237] Retrieved http://www.eftacourt.lu/default.asp?layout=article&id=29
[238] Retrieved http://www.eel.nl/cases/HvJ/C-692:0334.htm

Communities, the Kingdom of Spain did not consider it necessary to amend its national law to bring it into line with the Directive. Exercising the option provided for by Article 1(2) of the Directive, the Kingdom of Spain requested the exclusion of domestic servants employed by natural persons from the application for the provisions of the fund but it did not request the exclusion of higher management staff.[239]

The following questions were submitted for the preliminary ruling on the interpretation of Directive 80/987/EEC:-[240]

- Did Directive 80/987/EEC apply to all employees to the exclusion of those requested by the Kingdom of Spain (that is, domestic servants employed by natural persons)?
- In view of the fact that Spain had not specifically excluded higher management staff from the guarantee provided for in directive 80/987/EEC, could such staff be excluded from the general application of the guarantees provided for in Directive 80/987/EEC?
- In the event that the guarantees under Directive 80/987/EEC applied to higher management staff in Spain, should the specific implementation thereof be carried out by the ordinary body (that is the guarantee institution from which the higher management staff was excluded) envisaged for all other employees or by means of compensation directly from the State?

The European Court of Justice concluded that:[241]

- The Directive on the insolvency of employers was intended to apply to all categories of employees defined as such in the national law of a Member State, with the exception of those listed (excluded) in the annex of the Directive, that is, those the National State chose to exclude when exercising the option provided for by Article 1 (2).
- The Directive did not oblige Member States to set up single guarantee institutions, it left it to Member States to adopt the necessary measures to ensure guarantee institutions guarantee payment of employees' outstanding claims, therefore a separate guarantee institutions could be set up for higher management staff. The principle of

[239] Retrieved http://www.eel.nl/cases/HvJEG/692j0334.htm
[240] Retrieved http://www.eel.nl/cases/HvJEG/692j0334.htm
[241] Retrieved http://www.eel.nl/cases/HvJEG/692J0334.htm

interpretation in conformity with the Directive had to be followed in particular where a national court considered, as in that case, that the pre-existing provisions of its nation law satisfied the requirements of the directive concerned.

- Where the national provisions could be interpreted in a way that conformed with the Directive (as in casu) on insolvency of the employers and therefore did not permit higher management staff to obtain benefit of the guarantees for which it provided in that event Member State concerned was obliged to make good the loss and damage sustained as a result of the failure to implement the directive in their respect.
- Therefore in that case higher management staff were not entitled, under Directive 80/987/EEC, to request payment of amounts owing to them by way of salary form the guarantee institution established by national law for other categories of employees, and in the event that even when interpreted in the light of the Directive, national law did not enable higher management staff to obtain the benefit of the guarantees for which it provided such staff were entitled to request the state concerned to make good the loss and damage as a result of failure to implement the Directive in their respect.

4.4.8.3 Failure to transpose the provisions of the Directive in national law

In the case of Andrea Francovich and Others, Danila Bonifaci and Others v Italian Republic,[242] the plaintiffs employers became insolvent. Their claims could not be met. At that time the Italian state had not yet transposed the provisions of the Directive in its national laws. Consequently, the plaintiffs brought the proceedings against the Italian State, in which they claimed that, in view of its obligations to implement Directive 80/987/EEC with effect from 23 October 1983, it should be ordered to pay them their arrear of wages or in the alternative to pay compensation.

The courts of first instance, Pretura di Vicenza and Pretura di Bassano del Grappa (Magistrate's Courts) referred these matters to European Court of Justice for preliminary ruling.[243]

In its judgment the European Court of Justice examined two aspects namely:-

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[242] Retrieved http://www.eel.nl/cases/HVJEG/690J0006.htm
[243] Retrieved http://www.eel.nl/cases/HVJEG/690J0006.htm

- whether the provisions of Directive 80/987/EEC were sufficiently precise and unconditional?
- whether a Member State was obliged to make good loss and damage resulting from breach of its obligations under Community law?

With regard to the first point, the court examined three aspects namely:-[244]

- the identity of the persons entitled to the guarantee provided under the Directive;
- the content of the guarantee; and
- the identity of the person liable to provide the guarantee.

The Court held that "even though the provisions of the Directive were sufficiently precise and unconditional as regards determination of the persons entitled to the guarantee and as regards the content of the guarantee, those elements were not sufficient to enable individuals to rely on those provisions before the national courts. Those provisions did not identify the person liable to provide guarantee, and the State could not be considered liable on the sole ground that it had failed to take transposition measures within the prescribed period.[245]

As regards the second point (State liability), the Court held that " the principle whereby a State must be liable for loss and damage caused to individuals as a result of breaches of Community law for which the State could be held responsible is inherent in the system of the Treaty." It also said, "A further basis for the obligation of Member States to make good such loss and damage was to be found in Article 5 of the Treaty."[246]

It held that, "there should be a right to reparation provided that three conditions are fulfilled."

The first of those conditions is that the result prescribed by the Directive should entail the grant of rights to individuals. The second condition is that is should be possible to identify the content of those rights on the basis of the provisions of the Directive. Finally, the third condition is the existence of a causal link between the breach of the

[244] Retrieved http://ec.europa.eu/employment_social/labour_law/docs/02_insolvent_imp/report_en.pdf
[245] Retrieved http://www.eel.nl/cases/HVJEG/690J0006.htm
[246] Retrieved http://www.eel.nl/cases/HVJEG/690J0006.htm

State's obligation and the loss and damage suffered by the injured parties."[247] The court added that "it is on the basis of the rules of national law on liability that the State must make reparation for the consequences of the loss and damage caused."[248]

The court held that the abovementioned conditions had been met, and therefore the Member State was required to make good the loss and damaged caused to individuals as a result of failure to transpose Directive 80/987/EEC.[249]

4.5 SUMMARY

This chapter dealt with the transfer and insolvency of undertakings under the European Union law. There are two important Directives dealing with transfer and insolvency of undertakings under the European Union law, namely, Transfer Directive 77/187/EEC and Insolvency Directive 80/987/EEC. Both Directives impose obligations on Member States to transpose their provision in their national laws. Directive 80/987/EEC enjoins Member States to establish institutions guaranteeing payment of the employees' claims in the event of insolvency of their employer while Directive 77/187/EEC protects the rights of the employees on transfer and insolvency of undertakings.

In the next chapter it is proposed to articulate insolvency protection under the South African law.

[247] Retrieved http://www.eel.nl/cases/HVJEG/690J0006.htm
[248] Retrieved http://www.eel.nl/cases/HVJEG/690J0006.htm
[249] Retrieved http://www.eel.nl/cases/HVJEG/690J0006.htm

CHAPTER FIVE: INSOLVENCY PROTECTION UNDER SOUTH AFRICAN LAW

5.0 Introduction

As indicated above in chapter one and three[250] the provisions of section 38 of the Insolvency Act terminated all contracts of employment between the employer and employees upon sequestration of the estate of the employer. The automatic termination of contracts of employment was regarded as being by operation of law for which an employer could not be blamed. Employees had no remedy based on unfair dismissal against the employer. The result was that employees forfeited a number of accrued benefits such as arrears of salary or wages. payments in respect of accrued leave or holidays and severance pay. Further uncertainty prevailed as to whether the terminated contracts of employment in terms of section 38 of the Insolvency Act would revive should the business of the employer later be transferred as a going concern. These problems have been addressed with the recent amendments to the legislation. In this chapter it is now appropriate to interrogate these changes in the law.

5.1 Suspension of contracts of employment.

Section 38 of the Insolvency Act, 24 of 1936 was amended[251] with effect from the 01 January 2002. Subsection 1 thereof provides for the suspension of contract of service of employees whose employer has been sequestrated with effect form the date of the granting of a sequestration order. The result of suspension of contracts of employment is that the employees are not required to render their services in terms of their contracts of employment and therefore they are not entitled to any remuneration and no employment benefit accrues in terms of their contracts of employment.[252] However, the employees are entitled to the unemployment benefits in terms of the Unemployment Insurance Act, 63 of 2001 during the period of suspension.[253] Employees are, therefore,

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[250] p. 1 and 18 respectively
[251] Insolvency Amendment Act 33 of 2002
[252] Section 38(2)(9) and (b)
[253] Section 38 (3)

entitled to apply for unemployment insurance benefits in terms of section 17 of the Unemployment Insurance Act as if they are unemployed.

5.2 Termination of contracts of Employment

In terms of section 38(4) of the Insolvency Act the final liquidator or trustee has discretion to terminate contracts of employment of employees. However the final liquidator or trustee may not exercise such a discretion before consulting with any person whom the employer was required to consult in terms of collective agreement;[254] if there is no collective agreement that requires consultation, a workplace forum;[255] if there is no workplace forum, any registered trade union whose members are likely to be affected by the termination of contract of service;[256] if there is no such trade union, the employees or their representatives whose contract of service was suspended in terms of section 38(10).

5.3 Purpose of consultation

Section 38(6) introduces for the first time a rescue culture in the history of insolvency regime and requires that the consultation referred to above must be aimed at reaching consensus on the appropriate measures to save or rescue the whole or part of the business of the insolvent employer:-

- by the sale of the whole or part of the business of the insolvent employer; or
- by transfer as contemplated in section 197A of the Labour Relations Act, 66 of 1995; or
- by a scheme or compromise referred to in section 311 of the Compensation Act 1973; or
- in any other manner.

Section 38(7) of the Insolvency Act empowers the employees or their representatives to make proposals if they so wish with regard to consultation topics listed above. Such proposals must be submitted within 21 days of the appointment of the final trustee or

[254] Section 38 (5) (a)
[255] Section 38 (5) (b) (i)
[256] Section 38(5)(b)(ii)

the appointment of the final liquidator for a company or the appointment of a co-liquidator in the case of a close corporation or the date of conclusion of the first meeting if a co-liquidator is not appointed for a close corporation. It is submitted that the principle of consultation expounded by the courts in interpreting section 189 of the Labour Relations Act will apply equally to the consultation process referred to in section 38(5) of Insolvency Act.

In the case of National Union of Metalworkers of SA v Atlantis Diesel Engines (Pty) Ltd [257] the court emphasized the fact that, the trustee or the liquidator must in all good faith keep an open mind throughout and seriously consider proposals by the employees or by their representatives. In Atlantis Diesel Engines (Pty) Ltd v National Union of Metalworker of SA [258] the court held that consultation permitted employees who could be affected through no fault of their own to be heard. The court held further that consultation helped to minimize resentment, and thus, obviate industrial conflict, so serving the underlying policy of the Labour Relations Act. Consultation provides an opportunity for management both to explain the reasons for the proposed retrenchment and to discuss alternative measures. Employees have a chance to make meaningful and effective proposals on the need for the retrenchment process and to discuss alternative measures.

Further in terms of section 4 (2) (b) (i) and (ii), an insolvent debtor or his agent or a person entrusted with the administration of the deceased insolvent debtor who wishes to petition the court for the surrender of the debtor's estate for the benefit of the creditors must notify the employees or a registered trade union of his intention to do so by post and by affixing a notice of petition to a notice or place accessible to the employees within the premise of the insolvent debtor within seven days from the date of publication of such notice in the Gazette.

5.4 Automatic termination of contracts of employment

If the trustee or liquidator does not terminate the contracts of employment in terms of section 38(4), then unless he and the employees have agreed on continued employment with a view of saving or rescuing the business, contracts of employment will

[257] (1993) 14 ILJ 642 (LAC)
[258] (1994) 15 ILJ 1247 (LAC)

automatically terminate 45 days after the appointment of the final trustee or liquidator or a co-liquidator in the case of a close corporation.

Section 38 does not tell us as to what would happen to terminated contracts of employment should the business of the employer thereafter be sold as a going concern. Section 197A(2) of the Labour Relations Act takes account of this situation and according to the provisions thereof contracts of employment will be transferred to the new employer subject to the limitation contained therein. In terms of section 38(10), an employee whose contract of service has been suspended in terms of subsection 1, or terminated in terms of subsection 4 or 9, is entitled to claim compensation from the insolvent estate for any loss suffered by reason of suspension or termination of his contract of service prior to its expiration.

5.5 Severance Pay

As discussed above,[259] in the introduction to this chapter, sequestration or liquidation of an employers ipso jure terminated contracts of employment of employees. Because employees were not regarded as being dismissed by such termination it was an accepted fact that they were not entitled to severance pay in terms of the provisions of the Basic Conditions of Employment Act, 1997. The amended section 41(2) of the Basic Conditions of Employment Act 75 of 1997, as read with section 38(11) of the Insolvency Act, now provides that, for the purposes of severance benefits employees whose contract of service has been terminated due to the insolvency of the employer will be treated as employees who have been dismissed due to employer's operational requirements.

Section 41(2) of the Basic Conditions of Employment Act obliges an employer to pay an employee who is dismissed for reasons based on the employer's operational requirements severance pay equal to at least on week's remuneration for each completed year of continuous service with that employer calculated, in accordance with section 35.

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[259] p. 1

5.6 Salary or wages

Section 98A of the Insolvency Act regulates the order of preference of certain of the employee's claims for arrears of salary or wages where their contracts of service are terminated as a result of sequestration or liquidation of an employer. This section improved the ranking of claims of the employees by moving their preference up, thereby making them to rank prior to statutory claims that used to rank prior to them in terms of section 99 of the Insolvency Act.

Preference is accord to the following claims:

- Salary or wages in arrears for a period not exceeding three months, presently the maximum is R12 000-00.[260]
- Payment in respect of any period of leave or holiday due to the employee which has accrued as a result of his or her employment, in the year of insolvency or previous year whether or not payment thereof is due at the date of sequestration, presently the maximum is R4 000-00.[261]
- Any payment due in respect of any other form of paid absence for a period not exceeding three months prior to the date of the sequestration of the estate, presently the maximum is R4 000-00.[262]
- Any severance or retrenchment pay in terms of any law or agreement presently the maximum is R12 000-00.
- A claim for contribution payable by an insolvent in respect of former employee, presently the maximum is R12 000-00.

5.7 Summary

This chapter dealt with the improvements brought about by new section 38 of the Insolvency Act on the rights of employees upon insolvency of their employer.

The old section 38 of the Insolvency Act terminated contracts of employment of the employees. The problem was that when an undertaking was to be transferred there were no contracts of employment to transfer. The new section 38 of the Insolvency Act

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[260] Section 98A(1)(a)(i)
[261] Section 98A(1)(a)(ii)
[262] Section 98A (i)(a)(iii)

provides for suspension of contracts of employment so that when an undertaking is transferred there will be contracts of employment to transfer. The new section 38 also provides for consultation with the employees. Previously they were not consulted on their own right as employees of an insolvent employer. Further under the old section 38 employees were not entitled to a severance pay because they were not regarded as having been dismissed on the grounds of operational requirements. In terms of section 38(1) they are now entitled to severance pay. The main problem with these claims is that they are not guaranteed. If the insolvent estate of the insolvent employer is only enough to pay claims of the secured creditors, the claims of employees are not paid.

There are other ways in which the jobs of employees could be saved in the event of insolvency of the employer. This could be done by rescuing or rehabilitating a company which is in a financial distress, either by placing it under judicial management or the creditors and the company entering into an agreement of compromise or arrangement in terms of which they restructure their contractual relationship. In the next chapter it is proposed to deal with judicial management and compromise or arrangement as corporate rescue mechanisms of ailing companies in South Africa.

CHAPTER SIX: JUDICIAL MANAGEMENT AS A CORPORATE RESCUE MECHANISM

6.0 Introduction

The intention in this chapter is to discuss the rescue methods employed in South Africa to salvage a company which is in financial distress. The rescue methods are important because if they are successfully implemented employees' jobs can be saved. The rescue methods used in South Africa to salvage a company which is in financial distress are judicial management and compromise or arrangement. Provisions have been made for both judicial management and compromise or arrangement in the Companies Act 61 of 1973.[263] Judicial management is aimed at reviving a company which is on the brink of economic collapse and the salvaging of economically viable units to restore production capacity, employment and the continued rewarding of capital and investment.[264]

A company is placed under judicial management only when it is unable to pay its debts, and thereby is prevented from becoming a successful concern, and there is reasonable probability, that if placed under judicial management it many be enabled to pay its debts. The court may, on just and equitable grounds, order that the company be placed under judicial management. When such an order is granted, the company's directors are divested of the power and a judicial manager, usually a liquidator, is appointed to trade the company out of its financial difficulties.[265] In a compromise or an arrangement rescue procedure, the creditors and the company enter into an agreement in terms of which the creditors agree to waive or reduce their claims to allow the company to continue trading as a going concern. Both rescue procedures will be discussed hereunder with a view to evaluating as to whether they are reliable protective measures for the employees in the event of the insolvency of their employer. In comparison other jurisdictions will be discussed.

6.1 Shortcomings implicit in judicial management

The shortcomings implicit in South Africa judicial management is the fact that it has

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[263] Sections 427 and 311 respectively

[264] Kloppers, P; "Judicial Management in need of Reform:" Stellenbosch Law Review Volume 3 1999, 417"

[265] Section 427 (a) and (b) read with section 433

changed little since the inception of the Companies Act, 61 of 1973.[266] In other jurisdictions rescue regimes have been reformed to take into account the present day attitudes (that is rescue rather than liquidate) and diverse, vested interests that would be adversely affected should a company be liquidated.[267] One of the main shortcomings of the South African judicial management regime is its heavy reliance on court procedures.[268] The courts treat judicial management as an extraordinary measure because the creditors of a company are primarily entitled to liquidation as a means of recovering their claims.[269] Normally the court grants provisional judicial management order and it appoints a provisional judicial manager.

Before a provisional judicial management order may be granted the applicant must satisfy the court that there is a reasonable probability that the business will become a successful concern again. According to Kloppers,[270] different opinions exist among the judiciary and academics as to whether the same tests of reasonable probability should apply to the grant of final judicial management order or stricter test of "more than reasonable probability" should apply before granting the final order. The former test has been preferred above the latter test. The requirement that there must be a reasonable probability that the company will recover to the extent that it will be able to repay its debts in full has been criticized as being outdated, unrealistic and often contrary to the wishes of the creditors.[271] The other factor militating against the proper function of judicial management in South Africa is the traditional practice of appointing professional liquidators as judicial managers. The functions of a judicial manager differ from those of the professional liquidator. The function of the judicial manager is to resuscitate a company which is on the brink of economic collapse to regain its normal commercial life whereas the function of the liquidator is to stop the company which is in financial difficulties from trading and to sell its assets. Klopper point out [272] that the directors of a company in trouble would more easily be persuaded to apply for judicial management than to accept liquidation. However, once a provisional judicial manager

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[266] Kloppers, P.; "Judicial Management-A Coprate Rescue in Need of Reform" Stellenbosch Law Review Vol. 10 No 1999 417

[267] Kloppers Ibid. no. 266 at P 417; Kloppers, P; "Judicial Management Reform – steps to Initiate Business Rescue" (2001) 13 Mercantile Law Journal 359; Rajak, H and Henning, J; "Business Rescue for South Africa" 1999 (116) SALJ Part II 264 Stellenbosch Law Review Vol. 10 No 1999 417

[268] Kloppers, Ibid. no. 267 at p. 362, Rajak and Henning, op. cit. no. 267 p. 368

[269] Kloppers, Ibid. no. 267 at p. 362

[270] Kloppers, Ibid. no. 267 at p. 362-363

[271] Kloppers, Ibid. no. 267 at p. 363

[272] Kloppers Ibid. no. 266 at p. 417

is appointed it does not matter, to the person appointed if his investigations reveal that the company should rather be placed in liquidation. This means that even if the director's wishes would have been that the company should be placed under judicial management, once a provisional judicial manager has taken a decision that a company be liquidated that is the end of the matter. Kloppers points out [273] further that the fees for liquidation are often higher than the fees for judicial management. This represents a possible conflict of interest where a judicial manager or provisional judicial manager must recommend liquidation and then can apply for the appointment as a liquidator.

A further shortcoming of judicial management rescue scheme is that it is only available to companies. Other business concerns such as partnerships, sole proprietorship, business trusts and close corporations once declared insolvent are either sequestrated or liquidated.[274] Small businesses are also important in South Africa in that they reduce unemployment.

For these reasons and many others judicial management rescue scheme cannot, with all certainty, be regarded as a viable protective measure for employees in the event of the insolvency of their employer. It is for these reasons and others that Rajak and Hennining[275] equate it with unsupervised winding-up.

6.2 Compromise or Arrangement

Section 311 of the Companies Act 61 of 1973 provides mechanism in terms of which a company and its creditors could restructure their contractual relationships. This mechanism is capable of assisting in rescuing of an insolvent company debtor and in enabling a plan providing for survival of the debtor to be prepared and voted upon by those with an interest in or against the debtor company.[276] In terms of section 38(5) as read with subsection 6, employees of an insolvent company are entitled to be consulted in their capacity as employees of the insolvent company and to make proposals in regard to the rescue of the company in terms of section 311 of the Companies Act. The difficulty is that employees are not empowered in their capacity as such to make an

[273] Kloppers Ibid. no. 266 at p. 425
[274] Rajak and Henning Ibid. no. 267 at p. 268
[275] Rajak and Henning Ibid. no. 267 at p. 267
[276] Rajak and Henning Ibid. no. 267 at p. 266

application in terms of section 311 of the Companies Act. They can only do so as creditors of the insolvent company.

The shortcoming of this rescue scheme in practice is that the use of it is driven by the desire to gain tax benefits rather than to accomplish a proper business rescue.[277] The whole arrangement and its terms are thus geared at preserving an assessed loss for taxation purposes.[278]

The standard scheme in terms of section 311 shows no concern for creditors of the company, even less for the employees of the company.[279]

It is mostly employed where some one wants to acquire a company which enjoys the assessed loss for income tax purposes.[280] The targeted company would always be in provisional liquidation.[281] In such a sense the use of section 311 is aimed at the rescue of the corporate shell than the rescue of a viable commercial enterprise capable of making a useful contribution to the economic life of the country.[282]

Where the scheme is successful it will depend on whether the company is sold or transferred as a going concern. If it is sold or transferred as a going concern, then in that event the provisions of section 197A of the Labour Relations Act will apply and contracts of employment of employees will be transferred to the new employer subject to the limitation contained in section 197A.

Those employees who are dismissed will be entitled to protection afforded under the Labour Relations Act 66 of 1995 and Insolvency Act, 24 of 1936.

It is now appropriate to compare the South African rescue methods with those obtaining in the United Kingdom and Federal Republic of Germany, with a view to establishing as to whether there are lessons that could be learnt from these countries.

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[277] Kloppers Ibid. no. 266 at p. 428
[278] Kloppers Ibid. no. 266 at p. 428
[279] Kloppers Ibid. no. 266 at p. 429
[280] Kloppers Ibid. no. 266 at p. 429
[281] Kloppers Ibid. no. 266 at p. 429
[282] Kloppers Ibid. no. 266 at p.429

6.3 COMPARATIVE STUDY.[283]

6.3.1 England and Wales

With effect from 2003 the old administrative regime was abolished and replaced in its entirety by new provisions of the Enterprise Act 2002. The amendment to the old regime was prompted by the need to restrict administrative receivership. Receivers are normally appointed by a bank or lending institution to recover its security (private recovery). In most cases what is left after receivership is so slight that liquidation is inevitable.

The feeling was that the continued existence of receivership was incompatible with the notions of rescue and therefore needed to be restricted to few instances such as water and sewerage companies, air traffic services and railway companies[284].

Under the new Act, it is now possible for an administrator to be appointed by a holder of a qualifying charge or the company itself, simply by filing in various documents with the court. The appointment becomes effective without the need for a court hearing and without the need for a lengthy and expensive documentation to be prepared. Once an administrator has been appointed his/her functions would be to manage the affairs of the company for any of the following purposes: the survival of the company and the whole or any part of its undertaking as a going concern; the approval of a voluntary arrangement; the sanction of compromise or arrangement; a more advantageous realization of the company's assets than would be effected on a winding up[285]. The moratorium applies from the moment that the application is made to court or notice of intention to appoint an administrator is filed with the court, and:-[286]

- no resolution may be passed or an order made for the winding-up of a company;
- no administrative receiver of the company may be appointed;
- no other steps may be taken to enforce security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with the consent of an administrator or the leave of the court;

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[283] Retrieved http://www.meadeking.co.uk/Teams/Insolvency/Insolvency-Team.FAQ.htm
[284] Retrieved http://www.meadeking.co.uk/Teams/Insolvency/Insolvency-Team.FAQ.htm
[285] Retrieved http://www.meadeking.co.uk/Teams/Insolvency/Insolvency-Team.FAQ.htm
[286] Retrieved http://www.meadeking.co.uk/Teams/Insolvency/Insolvency-Team.FAQ.htm

- no other proceedings and no execution or other legal process may be commenced or continued and no distress be levied against the company or its property except with the consent of an administrator or the leave of the court.

Administration releases a company from the pressure of the creditors so that it can get time to work out a scheme to pay the creditors or which in the end might lead to the survival of the company again. Should the administrator make payments to the creditors, employees are accorded the status of preferential creditors. If a company is sold as a going concern employees are transferred to a new employer subject to certain limitations on their rights (see transfers above). If the company is closed down, the Government meets their various claims but subject to limits that are periodically revised. These claims are all paid by the Department of Trade and Industry which then claims as a creditor in the insolvency for the sums paid out.[287]

Another corporate rescue-type method existing in England and Wales is Corporate Voluntary Arrangeme(CVA)[288]. This method provides a framework for the type of debtor-creditor negotiation that is similar to that in the context of an informal workout. The decision to propose a Corporate Voluntary Arrangement is taken by the Directors of the company. The proposal is drawn-up by a licensed insolvency practitioner proposing a scheme to the creditors to maximize the return to them whilst allowing the company to continue to trade. The proposal is lodged with the court and then circulated to all the creditors together with a notice inviting them to attend a meeting to discuss the proposal for Corporate Voluntary Arrangement or they can vote by proxy. For the Corporate Voluntary Arrangement to be accepted, 75% in value of votes for those who opt to vote must be obtained. Once this target is obtained the proposals are binding on all the creditors who have been given notice of them. This means that all creditors are formally bound into the agreement without necessarily achieving 100% specific agreement.

A typical Corporate Voluntary Arrangement will last for between three and five years and will provide for the company to make voluntary contributions which are then paid to the appointed insolvency practitioner who will pay out dividends to creditors as and when it is economic for him to do so. At the end of Corporate Voluntary Arrangement

[287] Retrieved http://www.meadeking.co.uk/teams/Insolvency/Insolvency-Team.FAQ.htm
[288] Retrieved File://C:\Documents and Setting\Local/Settings/Temporary Internet Files.....

period if it is successfully completed then creditors are obliged to write off any part of the debt which has not been repaid.

6.3.2 Federal Republic of Germany

Insolvency proceedings may be initiated by the creditors or corporate debtors by filing a petition with a competent insolvency court. Before issuing an order, the court must be satisfied that the company is over indebted and that the available assets will, in all probability, cover the costs of the proceedings. In this order, the court appoints an administrator and sets a date for the so called report assembly, in which the creditors' committee will decide on how to proceed with the liquidation or restructuring insolvency plan.[289] The insolvency administrator is the person who advises the creditors about the financial position of the company and the options available to them. The liquidation of the company follows if the creditors' committee so opted at the report assembly.[290]

The court may, under exceptional circumstances, refrain from appointing an administrator and leave the assets under "debtor-management" whose action is supervised by a trustee. One prerequisite is that "debtor-management" should not perceivably disadvantage the creditors. The creditors play an important role in this context as "debtor-management" can be ordered and terminated by the court on their application. "Debtor-management" is met with great reservation in Germany in particular major creditors like banks hesitate to support the use of instrument more often.[291]

An insolvency plan is one of the corporate rescue method employed in Germany to save and restructure an ailing business. It may be initiated by the creditors or the debtors: It must be accepted by the creditors and the court. It consists of two parts, part one contains legal effects that the plan will have on debtors and creditors while part two sets out transactions proposed in order to achieve its objectives, for instance reduction of creditors' claims, restrictions on the rights of the secured creditors ect. In principle the plan must be approved by all groups of creditors, if there is a dissent the court will lean

[289] Retrieved http//:www.taucomord/European.%20business%20business20rescuemodesdo
[290] Retrieved http: /www.tau.comword European.%20business20%rescuemodesdoc
[291] Retrieved http: /www.tau.comword European%20business20%rescuemodesdoc

in favour of the dissenting group if it can be established that the plan is in the best interest of the creditors.[292]

6.4 Summary

This chapter dealt with the South African corporate rescue mechanisms, in terms of which a company in financial difficulties may be saved from being liquidated. These corporate rescue mechanisms may save employees jobs if successfully implemented. Further the chapter dealt with corporate rescue mechanisms in the United Kingdom and the Federal Republic of Germany with a view to comparing them with corporate rescue schemes obtaining in South Africa.

The South African corporate rescue mechanisms are judicial management and compromise or an arrangement. Both corporate rescue mechanisms have 'in essence' been a failures in practice. The main problem of both corporate rescue mechanisms is that they rely heavily on court procedures characterized by delays which a company in a financial distress may not survive.

In practice a compromise or an arrangement is being used to gain tax benefits rather than a proper rescue.

Judicial managements is administered by professional liquidators who do not have expertise in rehabilitating a company which has suffered financial misfortune, hence companies placed under judicial management are eventually liquidated.

Further, the courts treat judicial management as an extraordinary procedure that can be allowed only under exceptional circumstance. for instance, a company must be near insolvent or insolvent before a judicial management order may be granted. In practice it is difficult to rehabilitate a company which has reached such a state of affairs, hence companies under judicial management end up being liquidated. The United Kingdom corporate rescue mechanisms are administration and corporate voluntary arrangements. The involvement of the courts has been restricted in both rescue mechanisms. They are in the nature of informal work out, faster with fewer costs.

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[292] Retrieved http://www.tau.com/word European%20business20%rescuemodesdoc

The German corporate rescue mechanisms are insolvency plan and debtors' management. Insolvency plans allow the debtor and creditors to deviate from formal insolvency proceedings and to make their own informal workouts. It is a faster procedure with fewer costs. The involvement of the courts is restricted in these procedures. In debtor's management the debtor is allowed to continue to manage the assets of the company. The company continues to trade as usual. Employees continue to work.

In the next chapter it is proposed to deal with the protection accorded to employees in the event of insolvency of their employer at international level. The intention is to compare and give a wholesome picture of the protection of employees in the event of insolvency of their employer.

CHAPTER SEVEN: PROTECTION OF WORKERS CLAIMS: INTERNATION PERSPECTIVE

7.0 Introduction

The preceding chapters dealt with the protection of employees in the event of the insolvency of their employer in South Africa and under the European Union. In this chapter protection of employees under the ILO Convention 173 is going to be examined.

7.1 International Convention 173 of 1992

At international level the outstanding claims of employees in the event of insolvency of their employer are protected under ILO Convention 173 of 1992 concerning the protection of workers' claims in the event of insolvency of their employer[293]. Article 1(1) of the Convention defines insolvency for the purpose of the convention as "referring to situation in which in accordance with national law and practices, proceedings have been opened relating to an employer's assets with a view to collective reimbursement of its creditors."

According to Article 1(2) members are given discretion to extend the term "insolvency" to other situations in which workers claims cannot be paid by reason of financial situation of an employee, for example where the amount of employer's assets is recognized as being insufficient to justify opening of insolvency proceedings. Part II of the Convention protects workers' claims in the event of insolvency of their employer by way of privilege while Part III thereof protects the workers claims by way of guarantee institution. Member States have an election to accept either the obligations under Part II or Part III or the obligations of both parts. Members accepting the obligations of both parts of the Convention may, after consultation, with the most representative of the organization of employers and workers, limit, the application of Part III to certain categories of workers and to certain branches of economic activities.[294]

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[293] Retrieved file: /C:\DOWNLOAD\iloinsolvency-files\convde.htm
[294] Article 3(1) and (3)

7.2 Claims protected by way of privilege

The following claims are protected by way of privilege under Part II of the Convention:-

- workers' claims for wages relating to a prescribed period, not less than three months prior to the insolvency or termination of employment;[295]
- workers' claims for holiday pay due as a result of work performed during the year in which the insolvency or termination of employment occurred and the preceding year;[296]
- workers' claims for amount due in respect of other types of paid absence relating to a prescribed period, which should not be less than three months, prior to the insolvency or prior to termination of the employment;[297]
- severance pay due to workers upon termination of their employment.[298]

The effect of protection by way of privilege is that these claims must be paid out of the assets of the insolvent employer before non privilege creditors can be paid their share. The privilege afforded to these claim may be limited under certain circumstances but if they are so limited the prescribed amount should not fall below socially acceptable levels.[299] The prescribed amount should be adjusted to maintain its value.[300]

The Convention enjoins Member States to give workers claims a higher rank of privilege than most other privileged claims and in particular those of the State and social security systems. If however they are protected by guarantee institution in accordance with part III of the Convention they can be given a lower rank than those of the State and social security system.[301]

7.3 Guarantee Institutions

The workers' claims protected under guarantee institutions are the following:

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[295] Article 6 (a)
[296] Article 6 (b)
[297] Article 6 (c)
[298] Article 6 (d)
[299] Article 7 (1)
[300] Article 7 (2)
[301] Article 8 (1) and (2)

- workers' claims for wages relating to a prescribed period, which should not be less than eight weeks, prior to the insolvency or prior to the termination of the employment;[302]
- workers' claims for holiday pay due as a result of work performed during a prescribed period, which should not be less that six months prior to insolvency or prior to termination of employment;[303]
- workers claims for amounts due in respect of other types of paid absence relating to a prescribed period, which should not be less than eight weeks, prior to the insolvency or prior to termination of employment[304];
- severance pay due to workers upon termination of their employment.[305]

Article 9 of the Conventions is peremptory and obliges member states to establish guarantee institutions guaranteeing payment of the workers claims against their employer arising out of their employment when payment cannot be made by an employer because of insolvency. In terms of Article 11(2) member states may, in accordance with their particular characteristics and needs, allow insurance companies to provide the protection referred to in Article 9, as long as they offer sufficient guarantee. The importance of guarantee institutions is that payment of the claims of employees in the event of insolvency of their employer is guaranteed.

The shortcoming of the preference system is that, in practice, the protection afforded by preference is restricted, in that secured creditors have to be paid first and thereafter the preferential claims. The amount to be paid to creditors with preferential claims will depend on what is left after the secured creditors' claims have been met. In countries like South Africa the establishment of guarantee institution is an answer to the plight of employees who find themselves in a precarious position when a company has to be wound-up.

7.4 Summary

This chapter dealt with protection of employees' outstanding claims in the event of their employer's insolvency at international level. At international level the employees'

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[302] Article12 (a)
[303] Article12 (b)
[304] Article12 (c)
[305] Article 12 (d)

outstanding claims are protected under ILO convention 173 of 1992 concerning protection of workers' claims in the event of insolvency of their employer. The Convention obligates Member States to transpose its provisions in their national laws. The Workers' outstanding claims protected under the Convention are those arising our of their employment relationship. The protections accorded by the Convention are twofold, namely:-

- protection by means of privilege; and
- protection by means of guarantee institution.

The Conventions enjoins Member States give the workers' claims a higher rank of privilege than most other privileged claims and in particular those of the state and social security systems. Further the Convention enjoins Member States to establish institutions guaranteeing the workers' claims in the event of insolvency of their employer.

The chapter that follows contains own conclusions and recommendations.

CHAPTER EIGHT: CONCLUSIONS AND RECOMMENDATIONS

This study investigated the current protections of employees in the event of insolvency of their employer. Previously employees' contracts of employment were terminated by the insolvency of their employer. Employees were not entitled to consultation and information as employees of an insolvent employer. They were further not entitled to retrenchment packages because their contracts of employment were deemed to have terminated by operation of law for which nobody could be blamed. Employees were treated as mere concurrent creditors with low ranking claims against an insolvent estate of their employer. In the event the undertaking was to be sold or transferred there were no contracts of employment to transfer because they had been terminated by the insolvency of the employer. Further, employees could not be transferred to the new employer unless they had consented thereto.

The above problems were addressed by the amendments to the Labour Relations Act and the Insolvency Act. Although employees together with their contracts of employment could now be transferred to the new employer, the rights and obligations arising out of their contracts of employment are not passed over to the new employer. This means that the old employer remains liable for the outstanding claims of the employees that arose prior to the insolvency. The problem with these claims is that they are not protected should an employer be insolvent to an extent that he cannot meet them.

In the Member States of the European Union and at international level, the outstanding claims of employees are protected by means of institutions guaranteeing payments of outstanding claims of employees should an insolvent employer be unable to pay them. These claims are payable irrespective of whether or not the employer has remitted the contributions made by employees to the institutions. Directive 80/987/ECC of the European Union obliges Member States of the European Union and the countries falling within the area of the Treaty to establish these institutions. Member States which fail to establish these institutions are liable to make good the loss suffered by employees should an insolvent employee be unable to meet their claims. In South Africa there are no guarantee institutions. The claims of employees still depend on what is left after the claims of the secured creditors have been met. Should the available assets of the

insolvent employer be exhausted by the claims of secured creditors their claims are not met and there is nothing they can do.

South African rescue legislation is antiquated as compared to European Union modes of rescue. European countries have introduced several reforms to their insolvency legislation. The United Kingdom has replaced the old administration system with a new administration which restricts the court's involvement. In Germany there are insolvency plans which involve debtor and creditor negotiations. All these rescue modes are geared at rescuing a company which is in financial difficulties before liquidation becomes a reality. In this way employees' jobs are saved. The present South African rescue procedures need to be reformed.

In the light of the aforegoing it is our conclusion that the protections accorded to employees in the event of insolvency of their employer are still inadequate.

However, presently, the Department of Trade and Industry has published a draft Bill of the intended reform of the Companies Act. Chapter 6 thereof deals with rescue proceedings.[306] The Bill defines business rescue as proceedings to facilitate the rehabilitation by its management of a company that is insolvent or may imminently become insolvent. A company will in future be placed under rescue proceedings before insolvency becomes a reality.[307] This is confirmed by the fact that in future the Minister of Trade and Industry will be empowered to set the minimum value which if owed by the company to the creditor will constitute an insolvency event.[308] Acts of insolvency with regard to companies will in future be regulated. The directors will know exactly when the company is on the brink of being liquidated and could be held liable if despite this knowledge they continue trading recklessly.

The shareholders or the board of the company are placed in a position by the Bill to initiate rescue proceedings by an adoption of ordinary resolution[309]. This is a simplified procedure with fewer costs. However a resolution cannot be adopted if liquidation proceedings have been initiated. The resolution will have no force and effect until it has

[306] Retrieved http://www.turnaround-sa.com/pdf/companies%20BILL%202007%20chapter%206Business%20rescue%20Dr
[307] Section 130 (1) (b) of the Bill
[308] Section 131 (1) (a) and (2) of the bill
[309] Section 132 (1)

been filed with the Commission.[310] The involvement of the court has been curtailed in this respect. However the shareholders, creditors or employees or their representatives may after the adoption of the ordinary resolution approach the court and object against the resolution on the grounds that there is no reasonable prospects of rescuing the company.

They can also object to the appointment of the supervisor on the grounds that he is not properly qualified or is not independent of the company or its management.[311] It will be difficult for the affected person to have the resolution set aside by the court because he/she must produce overwhelming evidence in support of his/her application that there is no reasonable prospect of rescuing the company.

The Bill empowers the employees and other affected persons to approach the court and apply for an order that the company be placed under supervision if an insolvency event had occurred but the company has not adopted a resolution.[312] In the existing regimes employees are not empowered as employees of the insolvent employer to apply to court for an order that a company be placed under judicial management or a meeting be convened for compromise or arrangement.

A general moratorium applies during business rescue proceedings and no legal proceedings, including the enforcement of action against a company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum.[313] Unlike in a compromise or an arrangement no creditor will institute any legal proceedings against the company during rescue proceedings.

The salaries or wages of the employees accruing during business rescue proceedings are ranked second after the costs of the business rescue proceedings.[314] The claims of employees prior to the commencement of business rescue proceedings rank above all the claims of other unsecured creditors.[315] Employees' continuity of employment is

[310] Section 132 (2)
[311] Section 133 (1) (a) (b) (i) (ii) (iii)
[312] Section 134 (1)
[313] Section 136 (1)
[314] Section 138 (1) (a) (b) and (3)
[315] Section 147 (1)

guaranteed. During the business rescue proceedings the employees will continue to be employed on the same terms and conditions, except to the extent that changes occur because of prevailing circumstances or there is an agreement between the company and employees on terms and conditions that will save the company from being liquidated or there has been an agreement in an approved plan to provide otherwise.[316]

The company may not, during business rescue proceedings, unilaterally, abrogate or suspend entirely, partially or conditionally contracts of employment of the employees.[317] This section is aligned with section 38(5) of Insolvency Act 24 of 1936 which requires that employees must be consulted before their contracts of employment could be terminated.

The Bill accords employees the right to vote as creditors of the insolvent employer, the right to be consulted during the development of the business rescue plan and if the plan is not adopted, to propose the development of an alternative plan and to participate in the business rescue proceedings.[318]

If the Bill could be adopted as it is, this would mean that:

- Employees' continued employment is guaranteed during business rescue proceedings under the original terms and conditions of employment;[319]
- Their claims will rank above those of secured creditors post-commencement finance, that is, the finance that will be generated during rescue proceedings;[320]
- Their claims prior to commencement of rescue proceedings will rank above the claims of unsecured creditors;[321] and
- Employees will be involved in decision making processes in terms of their voting interest, participation in rescue proceedings and drawing of the business rescue plan[322].

[316] Section 139 (1) (b) (i) (ii) (iii)
[317] Section 139 (1) (2)
[318] Sections 147,151 154,155 and 156
[319] Section 139
[320] Section 138
[321] Section 147
[322] Sections 147.148 and 151

From my observation the intended business rescue legislation in the Bill is a hybrid of the present United Kingdom administration rescue regime and Federal Republic of Germany insolvency plan. Using the United Kingdom as a reference, it can be expected that the new dispensation will increase the success rate of business rescue from virtually zero percent to almost 50%, thereby cutting company liquidations by half.[323]

My recommendations are that:-

- the government should introduce a system of guarantee institutions that will ensure payments of employees claims should an insolvent employer be unable to meet their claims:
- the guarantee payments should not be dependent on the contributions made by the employees like in the United Kingdom and Federal Republic of Germany.
- the government should establish a state guarantee fund that will pay the outstanding claims of employees and reclaim the loss suffered from the estate of the insolvent employer;
- the new employer and the old employer should be made liable jointly and severally liable for the outstanding claims of employees prior to insolvency; or
- all rights and obligations of the old employer should pass to the new employer like in the Federal Repulic of Germany;
- the liquidator's (administrator) powers to terminate contracts of employment during rescue proceedings should be abolished;
- the administrators who will be dealing with companies in financial difficulties should be properly qualified to handle these situations;
- the rescue should be reformed along the line of practice in the European Union.

[323] Retrieved http://www.turnaround-sa.com/business%20rescue/business%20rescue.asp

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