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PITFALLS WHEN PURCHASING A BUSINESS

As pointed out in earlier instalments, the employment law consequences of purchasing a business as a going concern are governed by section 197 of the Labour Relations Act. A concern is normally sold as a going concern if the business as a whole is transferred and continued, or where the part of the business being transferred is able to operate independently and autonomously separately from what has been sold. The sale of only the shares in or the assets of a business, for example, is not viewed as the transfer of a going concern. Uncertainty exists however in our law whether contracting out of services is regarded as the transfer of a going concern.

Section 197 provides for the automatic transfer of the employees of the business to the buyer on the same conditions of employment that applied before the transfer, unless otherwise agreed beforehand between all parties concerned (being the buyer, the seller and the employees/trade union).

All existing rights that employees had against the seller, such as leave credit and fringe benefits are also transferred. This evidently also includes the rights of former employees that were established before the transfer. In other words, should a dispute about unfair discrimination, unfair dismissal or unfair labour practices exist before transfer, the buyer must accept responsibility for its outcome. The same applies to fees owed by the seller to employees or former employees at the date of transfer, for example in respect of severance pay, salary or incentive bonuses.

The facts of a case currently under review before the Labour Court serve as a good example. A company took over the business of another company as a going concern. At the time of transfer, there was a dispute pending between the seller and a former employee who had been dismissed due to misconduct more than two years earlier. The buyer was unaware of this. For various reasons, the referral to arbitration was delayed, through no fault of the employee. When arbitration eventually took place, the new owner was summoned to defend the case because in terms of section 197 he was now in the owner's shoes. Because the new owner had no information on the reasons for the employee's dismissal or could not find any witnesses to supply such information, he had no defense against the allegations of unfair dismissal. The outcome was that the employee won the case and was re-instated with retrospective effect with full payment of all salary and other benefits that she had lost in the interim. The new owner, if his review application to the Labour Court is unsuccessful, will be compelled to re-instate and pay the employee. If there is no longer a position available, he would have to dismiss her on operational grounds and pay her severance pay that would have to be calculated on the total of her years of service employed by her old employer, as well as by her new employer!

This situation merely serves to point out that buyers of businesses, no matter how big or small the business, should be extremely careful. It is advisable to gain professional advice on the legal implications of the transactions, to have the contract of sale drawn up by experts and to have a proper due diligence investigation done before signing the agreement. Such an investigation should investigate not only the financial soundness of the business being purchased, but should also determine the actual or potential liability that exists in respect of current, as well as former employees of the seller's business. Provision should be made for guarantees by the seller that all actual and potential claims by existing as well as former employees have been disclosed. The extent thereof should also be determined and indemnity for any claims that may be brought against the new owner should be supplied. Alternatively, the estimated cost of future liability may be calculated against the selling price, or it may be agreed that a part of the selling price be retained for an agreed period (e.g. 12 months) as insurance against potential claims.