

IN THE LABOUR COURT OF SOUTH AFRICA

HELD AT JOHANNESBURG

Case Number: J850/98

In the matter between

Applicants

and

Respondent

JUDGMENT

VAN NIEKERK AJ

Introduction

- [1] Mr. Joe Manchu is an entrepreneur. After completing his articles of clerkship with a firm of accountants and a short career in the corporate world, he decided to start a business. His vision was the establishment of a firm of black professional management consultants, which would create jobs and opportunity, and make some money in the process. He established the close corporation that is the

Respondent in these proceedings and offered a variety of management services relevant to the restructuring and transformation of businesses.

- [2] Sustained by his optimism and an overdraft, Manchu expanded his business during 1996 and 1997. During that period, he engaged a number of employees as management consultants, including most of the applicants.
- [3] Regrettably, the business failed to prosper. The first warning signs were apparent in July 1997, when cheques issued in respect of travel claims submitted by employees were dishonoured by the bank.
- [4] In the same month, Manchu and the consultants had a strategic planning meeting. The agenda of this meeting records an item relating to the Respondent's finances. Proposals were made on monthly and annual break-even figures, the required monthly contribution per team of consultants, and a series of incentives based on individual and team performance. Although those of the applicants who testified said that these items were not discussed in the context of any looming financial crisis, it is not disputed that the meeting reached agreement on them. Regular meetings were subsequently held with senior consultants, *inter alia*, to monitor performance against the targets set in July. Again, although the context of these meetings is disputed, Manchu's evidence that the targets relating to monthly income were never met subsequent to their establishment was not refuted.

[5] During December 1997, the bank advised Manchu that it would no longer honour salary cheques. After further discussions with the bank, and on the basis of a second bond registered over property owned by the Respondent, it was able to pay December salaries.

[6] On 22 January 1998, Manchu distributed a memorandum to all staff in which he reviewed events and the Respondent's performance during 1997. The memorandum said little if anything about the Respondent's dire financial situation. It acknowledged that although the year had started with great promise, a number of opportunities had not materialised. A particular shortcoming that was identified was the failure to engage in aggressive marketing. This had "caused the Firm significant financial losses and lost opportunities: and jobs were put at risk." Despite this observation, the tone of the memorandum is optimistic. There is nothing that suggests or hints at what was to transpire only 8 days later.

[7] On 30 January 1998, Manchu distributed another memorandum to the consultants. The relevant provisions of the memorandum read as follows:

Further to my memo of Thursday, 22 January 1998, I regret to inform you that the problems facing the Firm have worsened and that we have two options open to us: To close the firm down completely, or

To retrench most employees until prospects improve...

I have made every effort to protect the employment of each individual in the Firm.

However, in view of the above, I am no longer able to do so ... Even though the immediate future looks bleak, I remain hopeful about the long-term prospects of the firm. I therefore believe that closing down will not be in our long-term interest. The only option available then is to retrench all consultants with immediate effect.

For those retrenched employees, it need not be the end of the world. I shall do my utmost to assist employees to seek alternative employment wherever possible. I also undertake, when projects become available, to invite former employees whose skills and experience match the requirements of the project to partner with me on a project by project basis. I believe that I will be able to conclude some client agreements before the middle of the year. Also, if any of you does manage to interest a client in our services, then I will be happy to partner with you in executing the project. Your remuneration will be by negotiation and will obviously tend to be higher than the salary you have been earning, as it will be related directly to your own performance. There are definite opportunities open to each one of you to exploit. However, it is up to you.

The decision to retrench employees is never taken lightly. In this case, where I have come to know and like each and every one of you, it is even more difficult. I

appeal for your understanding in these difficult times, and assure you of my support in your future endeavours.

[8] Despite Manchu's appeal, the applicants were less than understanding about the termination of their employment. They were angry, and justifiably so. They testified that the memorandum came as a bolt from the blue. The applicants were not in the business of risk; they had accepted offers of employment with the Respondent and had an expectation of a degree of security. Some of them had given up secure employment to join the Respondent. All of them had structured their affairs in expectation of continued employment and a salary at the end of each month. They had dependants who relied on these expectations being met. Their anger was exacerbated by what they perceived to be attempts by Manchu to evade them and the questions they wished to address to him. Manchu's explanation is that he was busily engaged in efforts to raise cash to pay the January salary bill, and pursuing potential client assignments to ensure the future viability of the business.

[9] The applicants were eventually paid their January salaries, after Manchu had secured a bond against his home.

[10] On 30 March 1997 Manchu addressed a letter to each of the individual applicants in which he advised them that discussions with a potential business partner might

lead to an improvement in the prospects of the firm, and in anticipation of that outcome an offer of re-employment, on terms and conditions to be agreed, was made. The letter was sent by registered post. None of the applicants responded to the offer.

[11] Shortly afterward, on 20 April 1998, the applicants filed their statement of claim and initiated these proceedings.

[12] On 7 May 1998 the Respondent's attorneys addressed a letter to each of the applicants. The applicants were advised that the firm's business prospects had improved, and that each of them was offered re-employment on the same terms and conditions that prevailed on 31 January 1998, with effect from 1 June 1998.

[13] The first applicant, Mr. Mamabolo, responded on behalf of all of the individual applicants. He noted that the applicants had seriously considered the offer of re-employment, but that they believed that Manchu's conduct in terminating their employment had effected a breakdown of trust and that the employment relationship had irretrievably broken down. They stated further that "we are prepared to consider compensation as pleaded in our papers and nothing else."

[14] On 1 June 1998, the Respondent's attorney addressed a letter to the applicants' representative in which it made an open tender, without admission of liability, of

two months' salary in settlement of their claim, and of the severance pay to which some of the applicants were entitled. The applicants rejected this tender.

[15] The Respondent's prospects subsequently improved. An alliance was ultimately formed with a listed company, which acquired a share in the business. A restructuring of the business resulted in the issuing of debentures to secure a capital injection sufficient to clear its debts.

[16] After their dismissal on 30 January 1998, the applicants endeavoured to secure alternative employment. The majority of them were able to do so within a relatively short period. Of the three applicants who gave evidence, two (the 4th and 5th applicants) found alternative employment in April 1998 at rates either commensurate with or in excess of the remuneration they earned while employed by the Respondent. The 2nd applicant found alternative employment from 23 February 1998, earning considerably more than what he earned while employed by the Respondent. The evidence of the applicants relating to financial losses sustained consequent on their dismissal was in large measure confined to the cost of having to borrow money between 31 January and the date on which they resumed earning an income in their new employment. Those Applicants who did not give evidence during the proceedings submitted affidavits relating to events subsequent to their dismissal. The 3rd Applicant was employed on 1 May 1998, and the 1st and 6th Applicants were employed in July 1998.

Substantive Fairness

[17] Mr. Tyopo advised the court at the outset of the proceedings that he was disputing both the substantive and the procedural fairness of the applicants' dismissal. Mr. Hardie, who appeared for the Respondent, confirmed his client's concession at the pre-trial conference that the dismissal was procedurally unfair, and stated that he would be making submissions on the relief to which the individual applicants were entitled having regard to that concession and the time at which it was made.

[18] The first issue that the Court is required to determine is the substantive fairness of the applicants' dismissal. Section 188 of the Labour Relations Act, 66 of 1995 ("the LRA") requires an employer that dismisses an employee for reasons relating to operational requirements to establish a fair reason for the dismissal. The approach adopted by this Court is to require the employer to provide substantive proof of a need to retrench in the form of a commercially rational and sustainable reason, but not to question the commercial imperatives that underlay that decision, unless some ulterior motive is established. In other words, it is not the function of the Court to second-guess the employer's decision to retrench. It is not appropriate to intervene only because the decision taken by the employer was not the one to which the court would have come in same circumstances. See *SACTWU & Others v Discreto (A Division of Trump & Springbok Holdings)* [1998] 12 BLLR 1228

(LAC) at 1230E).

[19] There can be no doubt that at the time the applicants were dismissed, the Respondent was in serious financial difficulties. The business relied on the income generated by the applicants and the other consultants for survival. It is common cause that they failed to meet the agreed targets relating to fee income. The shortfall between the income that was generated and the monthly expenditure was funded by loans. It was inevitable that, at some point, the borrowed funds would no longer be sufficient to cover the increasing gulf between income and expenditure. This happened in December 1997, when the bank refused to honour salary cheques or extend further credit.

[20] In his evidence, Manchu submitted bank statements that establish that on 30 December 1997, the Respondent's bank account was overdrawn to the extent of R 182 736.83. The financial crisis facing the company is also evident from the Respondent's income statement for the year ending February 1998. That statement records a net loss for the year of R1 683 495.

[21] The defining moment for Manchu was the bank's refusal to extend further credit, and its demand for repayment of all outstanding loans. Manchu was faced with a hard choice. He could either close down the business, or retrench all of the consultants.

[22] In the evidence presented by the applicants, there was some suggestion, in veiled terms, that the real reason for retrenchment was a strategy to dismiss all of the applicants and to re-employ some of them. It was alleged that not all the consultants were dismissed, and that at least two of them were retained by the Respondent. To the extent that this suggestion implies the application of unfair selection criteria, there is no evidence to support that conclusion. Manchu's unrefuted evidence was that he retained only the services of the two secretaries, and that the two consultants concerned were dismissed on 30 January 1998 and engaged as independent contractors in March 1998. The suggestion of selectivity also overlooks the fact that by 30 March 1998, only 2 months after the retrenchment, Manchu had addressed letters to all of the applicants offering them re-employment. The letter of 7 May 1998 was written to each applicant offering re-employment with effect from 1 June 1998. These offers are not consistent with a nefarious strategy of selective re-employment on Manchu's part.

[1]

[23] During argument, the Applicants confined their attack on substantive fairness to 3 grounds. First, it was alleged that most of the documentation produced in support of the Respondent's financial state was produced by Manchu himself, and thus little weight could be attached to both his say-so and the documents. In his evidence Manchu testified that in addition to being the sole member of the Respondent he was also its accounting officer. He submitted a copy of the relevant

Form CK2 to verify his appointment. However, none of the Applicants who gave evidence could dispute Manchu's evidence of the Respondent's financial situation or the terms of the documentation adduced by him. In addition, certain of the documents, for example the copies of the Respondent's bank statements, are consistent with the figures presented by Manchu. Documentation from Nedcor Bank relating to the existence of two mortgage bonds support Manchu's evidence of his efforts to raise additional finance. For these reasons, I accept Manchu's evidence of the Respondent's financial situation.

[24] Secondly, it was suggested by Mr Tyopo that at the time of the retrenchment, there were projects that were generating income, and that the financial state of the company was not as precarious as Manchu suggested. The 2nd applicant gave evidence of projects current during January. These were small projects and were not expected to generate any significant fee income. The 5th Applicant gave evidence of a project in which she was involved. The income from that project was sufficient to pay half her salary for a quarter of a month. The 4th Applicant also gave evidence of a project proposal anticipated to bear fruit in February 1998. That project, however, was expected to last some 2 weeks, and would generate an amount of R40 000. That amount did not take into account a share to which a collaborating consultancy would be entitled. On the applicants' own evidence, the projects that had some possibility of generating work at the time the applicants were retrenched were not sufficiently lucrative to address the Respondent's

financial difficulties, or of such a magnitude so as to affect the commercial rationality of the choice Manchu made on 30 January 1998.

[25] Finally, it was suggested that the business ran two bank accounts, and that the accounts introduced by Manchu into evidence related to only one of them. The implication, as I understood it, was that the second account was used to settle certain of the obligations incurred in respect of the first, and that things were not as bad as they might appear. Manchu gave evidence to the effect that there was a current account in the name of Manchu Consulting, but that for all intents and purposes it was a personal account. His salary was paid into this account. On one occasion, he had drawn cheques from the account to pay employees when cheques drawn on the CC's account had been dishonoured. When funds permitted, a refund was effected by drawing a cheque on the CC's account in favour of the Manchu Consulting account. This explanation was not refuted either by those of the applicants who gave evidence, or in cross-examination. I accept therefore that the existence of two bank accounts in the circumstances described by Manchu does not impact on the existence or otherwise of a fair reason to dismiss the applicants.

[26] As I have noted, it is not for this Court to determine whether or not Manchu made the right choice. Manchu cannot be criticised either for formulating the choices before him in the way he did, or for exercising the alternative that led to the retrenchment of the individual applicants. His decision was not commercially

irrational, nor was it made in bad faith. I find therefore that the dismissal of the applicants was substantively fair.

Procedural Unfairness

[27] Section 189 of the LRA provides that when an employer contemplates dismissing employees for operational reasons, the employer is required to consult with them or their representatives over a range of issues. A failure to comply with this section will almost invariably result in the dismissal being unfair on procedural grounds. (See *Johnson and Johnson (Pty) Ltd v Chemical Workers Industrial Union* [1998] 12 BLLR 1209 (LAC) at 1217D).

[28] As I have noted, the Respondent conceded that the dismissal was procedurally unfair in that it failed to comply with any of the requirements imposed by s189. All that remains therefore is for the Court to determine the relief, if any, to which the individual applicants are entitled as a consequence of that concession.

[29] The applicants do not seek reinstatement or re-employment. They seek only to be compensated for the unfairness of their dismissal. Section 194 of the LRA regulates awards of compensation when a dismissal has been found to be unfair, both in a substantive and a procedural sense. That section provides:

- (1) *If a dismissal is unfair only because the employer did not follow a fair procedure, compensation must be equal to the remuneration that the employee would have been paid between the date of dismissal and the last day of the hearing of the arbitration or the adjudication, as the case may be, calculated at the employee's rate of remuneration on the date of dismissal. Compensation may however not be awarded in respect of any unreasonable period of delay that was caused by the employee in initiating or prosecuting a claim.*
- (2) *The compensation awarded to an employee whose dismissal is found to be unfair because the employer did not prove that the reason for dismissal was a fair reason related to the employee's conduct, capacity or based on the employer's operational requirements, must be just and equitable in all the circumstances, but not less than the amount specified in subsection (1), and not more than the equivalent of 12 months' remuneration calculated at the employee's rate of remuneration on the date of dismissal.*
- (3) *The compensation awarded to an employee whose dismissal is automatically unfair must be just and equitable in all the circumstances, but not more than the equivalent of 24 months' remuneration calculated at the employee's rate of remuneration on the date of dismissal.*

[30] The manner in which the provisions of section 194 (1) are to be applied was clarified by the Labour Appeal Court in *Johnson and Johnson (Pty) Ltd v CWIU*,

supra.

[31] The Labour Appeal Court summarised the position as follows:

If a dismissal is found to be unfair solely for want of compliance with a proper procedure the Labour Court, or an arbitrator appointed under the LRA, thus has a discretion whether to award compensation or not. If compensation is awarded it must be in accordance with the formula set out in s.194 (1); nothing more, nothing less. The discretion not to award compensation in particular cases must, of course, be exercised judicially.

(at 1219J-1220A)

[32] The Labour Appeal Court provides at least one example of what might constitute a basis for a refusal to award compensation. At page 1220D of the report the Court adds that:

The nature of an employee's right to compensation under s.194 (1) also implies that the discretion not to award that compensation may be exercised in circumstances where the employer has already provided the employee with substantially the same kind of redress (always taking into account the provisions of s.194 (1)), or where the employer's ability and willingness to make that redress

is frustrated by the conduct of the employee.

[33] An order for payment of compensation for failing to give effect to the right to a fair procedure is not based on patrimonial or actual loss. The nature of the compensation is a *solatium* for the loss of a right, it is a form of redress, in the nature of a fixed penalty for a legal wrong (at 1220B). If an employer has either tendered substantially the same kind of redress, or if an employee frustrates the ability or willingness of the employer to make that redress, the employee should not be entitled to benefit.

[34] In the exercise of my discretion I must obviously take into account that the procedure prescribed by section 189 was not followed at all. Had Manchu consulted with the applicants, had he made proper financial disclosure of the company's affairs and had he explored alternatives to retrenchment with the applicants, this dispute may never have arisen.

[35] The compelling consideration, however, is the offer made by the Respondent and the attitude adopted by the applicants to those offers. There is no evidence to suggest that the various offers made by Manchu were not *bona fide*, or as a genuine attempt to make redress for the wrong he realised that he had committed by failing to comply with s189. In so far as any breach of trust may have inclined the applicant to look at Manchu's various offers of re-employment with a degree

of skepticism, I do not accept for the purposes of determining their right to compensation that they were entitled to adopt that attitude. The fact of the matter is that the applicants refused to consider any of the alternatives put to them; they resolutely maintained their intention to hold out for what they termed “the maximum compensation”. All of the applicants obtained alternative employment in a relatively short period, and in most instances, at levels of income that ensured that any financial loss they suffered was not excessive. Although their patrimonial or actual loss is not relevant to their entitlement or otherwise to the fixed penalty established by s194, their financial loss, and the extent of it, is relevant to a consideration of the reasonableness of Manchu’s offers, and to the degree of redress those offers represent. The Applicants motive in rejecting the Respondent’s various offers can only have been mercenary in the sense of an expectation that they would be more generously compensated by this Court.

- [36] This is one of those instances referred to in *Johnson & Johnson* where the employer’s willingness to make redress was frustrated. On balance, I am of the view that to deny the applicants compensation would be less unfair than to award them the equivalent of 12 months’ remuneration each which would otherwise be required by s194.

Severance Pay

[37] Finally, there is the question of severance pay. Section 196 (10) of the LRA provides that:

If the Labour Court is adjudicating a dispute about a dismissal based on the employer's operational requirements, the court may inquire into and determine the amount of any severance pay to which the dismissed employee may be entitled and the court may make an order directing the employer to pay that amount.

[38] In *Whall v Brandadd Marketing (Pty) Ltd* (Case No. J1130/97), after grappling with the stark choice established by the rule in *Johnson and Johnson*, Grogan A J adopted the view that s196(1) read with s196(10) confers a discretion on the Court to inquire into and determine the amount of severance pay to which the employee might be entitled. This, he suggested, could then be ordered to be paid in lieu of compensation, and he made an order to that effect. Mr Hardie submitted that I should adopt a similar view if I were inclined to grant the applicants something less than the statutory amount to which they would be entitled should I decide to award compensation.

[39] I am not persuaded that s196 confers any latitude on the part of the Court to make orders for compensation other than in terms of the minimum of one week remuneration for every year of completed service. Neither s196 nor s158

specifically confers the power on this Court to make such orders. Section 196 incorporates the various alternatives by which variation of the statutory formula may be effected. Section 196(2) provides that the Minister, after consultation with NEDLAC and the Public Service Co-ordinating Bargaining Council, may vary the amount of severance pay in terms of subsection (1) by notice in the Government Gazette. Exemptions from the obligation to pay severance pay can only be granted by the Minister. Severance pay is also a matter over which parties are required to consult (See s189). In my view, it is not appropriate for this Court to intervene either to upset any agreement on the amount of severance pay, or to interfere where the parties are unable to reach consensus on an improvement over the statutory formula.

[40] Despite the Respondent's tender of severance pay, those of the applicants entitled to severance pay did not accept that offer. However, their failure to do so cannot preclude the Court from ordering payment of what is their statutory right.

[41] Finally, there is the question of costs. When the Respondent made its tender of two months' compensation on 1 June 1998, it warned the applicants that in the event of their refusing the tender and being awarded a lesser amount by this Court, the Respondent would be seeking an appropriate order for costs. The applicants have failed to secure the payment of any compensation at all. In these circumstances, the Respondent is entitled to its costs from 1 June 1998.

[42] I accordingly make the following orders:

1. The dismissal of the applicants on 30 January 1998 was substantively fair but procedurally unfair.
2. The applicants are not entitled to compensation in consequence of their dismissal.
3. The first, second and fifth applicants are each to be paid the equivalent of one weeks' remuneration, to be calculated in accordance with their respective rates of remuneration on 31 January 1997, within 7 days of the date of this judgment.
4. The applicants are to pay the costs of the Respondent, from the date of the Respondent's tender on 1 June 1998, jointly and severally, the one paying the other to be absolved.

ANDRÉ VAN NIEKERK A J

Judge of the Labour Court

OF HEARING: 22, 23 February 1999

OF JUDGMENT: 12 March 1999

Mr Mxolisi Tyopo of TYOPO NCUBE ATTORNEYS

e Respondent: Mr Stephen Hardie of EDWARD NATHAN AND FRIEDLAND