

South Africa

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GENERAL

1. To what extent does national law specifically regulate outsourcing transactions?

National law does not specifically regulate outsourcing transactions.

2. What additional regulations may be relevant on:

- A financial services outsourcing?
- A business process outsourcing?
- An IT outsourcing?
- A telecommunications outsourcing?
- A public sector outsourcing?
- Other outsourcings?

Financial services

Banks in South Africa who outsource operations to a third party must notify the South African Reserve Bank (SARB) of any outsourcing arrangements that (*Banks Act Circular (14/2004)*):

- Have a bearing on the risk profile of the bank.
- Affect the systems and controls of the bank.
- The bank's management classify as being of strategic importance.
- Have implications for SARB's discharge of its supervisory responsibilities.

The bank must:

- Investigate the competence of the proposed supplier and verify the supplier's ability to perform at the required service levels for the duration of the agreement.
- Set up appropriate structures to ensure ongoing management and monitoring of the terms of the outsourcing arrangement.

- Have stringent service level agreements with early exit provisions (*see Question 16*).
- Have formal contingency plans in place.

Outsourcing agreements must specifically allow SARB access to all relevant information in order for it to carry out its regulatory functions. If a supplier is located outside of South Africa, the bank must ensure that SARB can effectively conduct its supervision duties.

SARB does not allow the outsourcing of a bank's internal audit function to a third party (*Banks Act Circular*).

Business process

There are no specific regulations that are relevant to business process outsourcing.

IT

There are no specific regulations that are relevant to IT outsourcing.

Telecommunications

There are no regulations that deal specifically with telecommunications outsourcing. However, the supplier must comply with any relevant aspects of the telecommunications laws and regulations (the main law is the Electronic Communications Act 2005). The supplier may also need to be appropriately licensed and/or to obtain consents or approvals. In some cases, depending on the outsourced services, the supplier must comply with telecommunications regulations over and above those which apply to the customer.

Public sector

Any public sector outsourcing or procurement tender process requires careful consideration of the various legislative constraints under which it is conducted. All government procurement in South Africa must be fair, equitable, transparent, competitive and cost-effective (*Constitution of South Africa*). Statutes regulating these activities include:

- The Public Finance Management Act.
- The Municipal Systems Act.
- The Municipal Finance Management Act.
- The Broad Based Black Economic Empowerment Act.
- The Promotion of Administrative Justice Act.
- The Preferential Procurement Policy Framework Act.

Common law and the general rules applicable to administrative and constitutional law also apply and public entities are required to act strictly within the legal bounds conferred on them by statute.

Other

There are no specific regulations relevant to outsourcing.

LEGAL STRUCTURES

3. In relation to the legal structures commonly used on an outsourcing, please describe how each structure works, and its potential advantages and disadvantages.

Single supplier outsourcing

Single supplier outsourcing is the most common form of outsourcing arrangement. An entire service requirement is outsourced to one supplier with whom a comprehensive outsourcing agreement is concluded. If the services require the services of a third party other than the supplier, it is the supplier's responsibility to subcontract such services to the third party, usually with the customer's prior written consent. Despite any such subcontracting, the supplier continues to retain full responsibility for the service provision to the customer. Therefore, the supplier is responsible for meeting the full set of service levels which are imposed on it by the customer in the terms of the agreement. The supplier is usually required to take out adequate insurance to cover its risks under the contract. The customer may require a parent company guarantee from the supplier's ultimate parent company.

Multiple-vendor sourcing

For strategic business or technical reasons a customer may prefer to engage in sourcing arrangements with multiple suppliers within the same service or operational area or division within its business. If so, the customer enters into separate agreements with each supplier but must ensure that appropriate accountability is contracted for with each supplier, with stringent provisions that each supplier fully co-operate with the others when required. This type of arrangement requires specific management of:

- Each of the suppliers.
- The interfaces between the services which each supplier provides to the customer.

Service provider with an integrator function

In the multiple-vendor sourcing model (see above, *Multiple-vendor sourcing*) the customer must integrate and co-ordinate the services of each of the suppliers. In this model the customer contracts a third party to carry out this function instead and has that party ensure timely, seamless and continuous service performance between all the relevant suppliers.

Joint venture (JV) arrangements

In some cases, the customer enters into a JV arrangement with its supplier, setting up a separate company in which both the customer and supplier has an interest. This allows both parties to commercially benefit from the arrangement. The customer can

therefore exercise greater control in the management and operation of the JV and the ultimate service provision to itself.

PROCUREMENT

4. Please briefly describe the procurement process that is usually used to select a supplier of outsourced services (including due diligence and negotiation).

The first step in any outsourcing process is that the customer must comprehensively analyse its specific business processes and problems and come up with the most practical and workable solution. This solution is then drawn up into a request for information (RFI) or request for proposal (RFP) specification document.

The customer then identifies and invites potential bidders to respond to the RFI or RFP. In some cases, a customer may first issue a RFI and then require formal bids in a subsequent RFP process. As part of the RFP documentation, the customer may include:

- The text of the outsourcing contract which it intends to conclude with the successful bidder (or a term sheet containing the key legal risks which a bidder must assume).
- Its required service levels.
- Specific service requirements.

The customer assesses and evaluates the RFI and/or RFP responses. This may include onsite investigations, client site visits and due diligence exercises on the bidders. The bidders may also carry out a due diligence exercise of the customer's service environment to allow for more accurate and binding pricing offers. The timing of these due diligence exercises depends on the number of phases in the tender process. Generally, the customer does not choose a successful bidder before it has shortlisted and entered into negotiations with a number of the bidders.

Additional regulatory requirements apply to outsourcing in the public sector (see *Question 2, Public sector*).

TRANSFERRING OR LEASING ASSETS

5. What formalities are required to transfer the following assets on an outsourcing:

- Immovable property?
- IP rights and licences?
- Movable property?
- Key contracts?

Immovable property

The transfer of immovable property must be made in writing through a Deed of Transfer registered by the Registrar of Deeds (*section 16, Deeds Registries Act 47 of 1937*). Where the prop-

erty is leased, the consent of the landlord or licensor may be required to transfer the lease to the supplier.

IP rights and licences

A transfer of IP rights must generally be in writing and may require registration of the transfer, depending on the IP rights involved. Transfer or assignment of patents rights, design rights and trade marks in particular must be made in the prescribed manner.

The transfer of IP licences must generally be by written assignment and may, in addition, require the licensor's consent.

Movable property

Ownership of movable property is transferred by delivering the property to the supplier with the specific intention of transferring ownership. However, a written assignment is usually recommended for evidential purposes and would generally be recorded in an outsourcing agreement. Where assets are leased, the transfer usually requires the lessor's consent.

Key contracts

An outsourcing agreement generally provides that key contracts be transferred by written assignment. Key contracts must be reviewed to determine whether the counterparty's written consent is required before the contract can be transferred to a new supplier. Alternatively, the customer can agree with the new supplier that it liaise with the counterparty to ensure its performance under the contract with the customer, if either:

- The customer wishes to retain its contractual relationship with the counterparty.
- Key contracts cannot be transferred.

6. What formalities are required to lease or license the following assets on an outsourcing:

- **Immovable property?**
- **IP rights and licences?**
- **Movable property?**
- **Key contracts?**

Immovable property

As with transfers, written documents are required for leases and subleases of immovable property and the need for the landlord's consent must be considered (see *Question 5, Immovable property*).

IP rights and licences

A written agreement should be entered into as a matter of good practice to record the terms agreed in relation to the grant of a licence to use IP rights (see *Question 5, IP rights and licences*).

Movable property

A written lease should be entered into as a matter of good practice to record the terms agreed.

Key contracts

The concept of a contract being leased or licensed is not generally recognised under South African law. In practice:

- Rights under a contract can be assigned (subject to consent where necessary).
- Rights and liabilities can be novated.
- A third party can exercise rights or perform obligations as an agent or subcontractor of the contracting party.

Therefore, good practice provides that the customer both:

- Enters into a written contract that clearly sets out the basis on which it is leasing the contract to the supplier.
- Considers the need for counterparty consent.

TRANSFERRING EMPLOYEES

7. In what circumstances (if any) are employees transferred by operation of law:

- **To an incoming supplier on an initial outsourcing?**
- **To an incoming supplier on a change of supplier?**
- **Back to the customer on termination of an outsourcing?**

Initial outsourcing

If the whole or a part of any business, trade, undertaking or service business is transferred as a going concern from one employer to another then the new employer is automatically substituted in place of the old employer in respect of all employment contracts in existence immediately before the date of transfer (*section 197, Labour Relations Act, 1995 (LRA)*).

If a service within a company forms an integral unit, and the supplier takes over the unit, its transfer constitutes the transfer of part of a business and section 197 of the LRA (section 197) applies. This means that the employees working on the services being outsourced automatically transfer to the supplier. However, employees can refuse the transfer to the supplier and instead tender their resignation.

Change of supplier

Change of supplier is known as second-generation outsourcing. It is currently unclear in case law as to whether the provisions of section 197 (see above, *Initial outsourcing*) apply.

Termination

Section 197 is unlikely to apply on termination of an outsourcing agreement.

8. Please describe the terms on which employees would transfer by law, including any effect on pensions, employee benefits or other matters (including collective agreements) that the transfer may have.

General terms

All rights and obligations between the old employer and an employee at the time of transfer continue to remain in force (*LRA*). The supplier can however alter some terms and conditions of employment by agreement with the transferred employees (see below, *Pensions*).

Pensions

The supplier can place transferred employees on a different pension fund, provided that the relevant provisions of the Pensions Fund Act 1956 are followed (*LRA*). These include (*section 14(1)(c), Pension Funds Act*):

- Any scheme to amalgamate or transfer pension funds must be reasonable and equitable.
- Employees' rights and reasonable expectations under pension fund rules or established practice must be taken into account.

Employee benefits

All contractual benefits (for example, medical insurance or severance pay) transfer with the transferred employees (*LRA*).

Other matters

The supplier is bound by all arbitration awards or collective agreements binding on the old employer.

For 12 months after the transfer, the old employer is jointly and severally liable with the supplier to any employee who becomes entitled to receive a payment as a result of the supplier's dismissal for a reason relating to the supplier's operational requirements, liquidation or sequestration. This is unless the old employer is able to show that it has complied with the provisions of section 197 of the *LRA* (see *Question 7, Initial outsourcing*).

9. What information must the transferor or the transferee provide to the other party in relation to any employees?

The old employer must (*section 197(6), LRA*):

- Agree with the supplier a valuation (as at the date of transfer) of:
 - the leave pay accrued to the transferred employees of the old employer;
 - the severance pay that would have been payable to the transferred employees of the old employer in the event of a dismissal arising from the supplier's operational requirements;

- any other payments that have accrued to the transferred employees but that have not been paid.

- Conclude a written agreement that specifies which employer is liable for any of the above payments, or if liability is shared between them, the terms under which it is split.
- Disclose the terms of the agreement to each employee who becomes employed by the supplier after the transfer.
- Take any other measures that are reasonable in the circumstances to ensure adequate provision for any obligation on the supplier that may arise.

10. What information and consultation obligations arise for the transferor and the transferee in relation to employees or employees' representatives?

The transferor and the transferee have no obligation to engage in prior consultations with their respective employees in an automatic transfer under section 197.

However, if the parties intend to vary the automatic consequences of section 197, a written agreement must be concluded between either the old or new employer (or both employers acting jointly) and the employee or trade union. The issues which would have to be agreed include:

- Whether contracts of employment will be automatically transferred.
- The rights and obligations to be transferred.
- Issues relating to discipline and disciplinary records.
- The date of transfer.
- Pension fund issues.
- Whether collective agreements and organisational rights will be transferred.
- The transfer of terms and conditions of employment, if any.

11. To what extent can a transferee harmonise terms and conditions of transferring employees with those of its existing workforce?

The transferee may seek consensual amendments to existing contracts of employment for certain categories of employees through collective bargaining. It can impose unilateral variations, although the transferred employees' new terms and conditions cannot be less favourable overall than those provided by the transferor. Therefore, the transferee can vary certain contractual terms and conditions to the employee's detriment for reasons of harmonisation, provided that this is adequately compensated by an improvement in some other respect.

12. To what extent can dismissals be implemented before or after the outsourcing?

Dismissals can be implemented before or after the outsourcing but a dismissal is automatically unfair if the reason for the dismissal is related to the transfer.

This does not prohibit the dismissal of employees resulting from bona fide operational requirements that arise in the context of the transfer. This is provided that the transfer or any related reason is not the reason for the dismissal, both before and after the outsourcing.

13. In what circumstances (if any) is it possible for the parties to structure the employee arrangements of an outsourcing as a secondment?

It is possible to structure the employee arrangements of an outsourcing transaction as a secondment from the customer to the supplier, but section 197 is still relevant. The test is whether a transfer of a business has taken place from one employer to another as a going concern, regardless of whether the contract has been structured as an employee secondment (see *Question 7, Initial outsourcing*).

DATA PROTECTION

14. What data protection issues may potentially arise on an outsourcing and how are they typically dealt with in the contract documentation?

Various South African legislation aims to protect the right to privacy of information, including the:

- Constitution of South Africa.
- Promotion of Access to Information Act 2001.
- Electronic Communications and Transactions Act 2002.

However, South Africa does not have stringent data protection laws in place, although legislation is expected to be enacted within the next few years and will likely be based on the principles of EC Directive 95/46/EC on data protection.

Nevertheless, outsourcing agreements generally include an undertaking by the supplier that it will strictly comply with:

- All applicable laws relating to data privacy.
- Any of the customer's specific data protection policies and procedures.

This can include detailed restrictions and rules relating to the supplier's ability to process, copy, store, retrieve and transfer any customer data.

SERVICES

15. How is the services specification typically drawn up and by whom?

The parties usually draft the services specification together, taking into account the specific services required by the customer and the supplier's specific knowledge of the service.

16. How are the service levels and the service credits scheme typically dealt with in the contract documentation?

The parties usually identify and agree on quantitative and qualitative performance levels to measure the supplier's performance of the services. The parties then agree which party is responsible for measuring compliance with the service levels and, where service levels are not met, what compensation (if any) is payable.

Any penalty imposed for failing to meet a service level is generally referred to as a service credit. Generally, service credits are either set-off against any fees payable to the supplier or the supplier issues a credit note to the customer for the amount. It is important to ensure that any service credits imposed are fair and reasonable, as any claim for a penalty which is out of proportion to the prejudice suffered by the customer may be subject to reduction or rejection by the courts (*Conventional Penalties Act, 1962*).

Alternatively, the arrangement is often that the supplier can obtain service debits (and thereby claw back any service credits which it incurs) for exceeding the contracted level of service.

CHARGING

17. Please describe the charging methods that are commonly used on an outsourcing (for example, risk or reward, fixed price, cost or cost plus, pay as you go, resourced-based charges, use of minimum charges and so on).

Depending on the services being outsourced, a variety of pricing models and methodologies can be applied. These include:

- A fixed price for the services.
- An agreed contracted savings arrangement.
- Gain share arrangements.
- Cost-plus pricing.
- Variable charges and transaction based fees based on usage.

Agreements often provide for pricing on a time and materials basis for out-of-scope services or where the specifications of the services cannot be defined. The customer must ensure that the supplier has submitted a detailed quotation for its approval before any services are undertaken, on a time and materials basis.

18. Please briefly describe any other key terms used in relation to costs, such as charge variation mechanisms and indexation.

Variable pricing is usually governed by:

- Index changes to take inflation into account, for example according to:
 - the consumer price index;
 - changes in petrol prices;
 - salary based indices;
 - market changes.
- Audit rights, which allow the customer to investigate charges and charging mechanisms. If any errors or overcharges are discovered during an audit exercise, the contract should oblige the supplier to refund them.
- Benchmarking provisions.
- Most favoured customer status provisions, which oblige the supplier to reduce its prices to the customer if it is providing the same service to any other customers at a lower price.
- For services which have a foreign currency component or impact to the supplier, pricing terms usually:
 - provide a mechanism to cater for changes in the applicable exchange rate;
 - state which of the parties is responsible for taking out forward cover, if applicable.

CUSTOMER ISSUES

19. If the supplier fails to perform its obligations, what relief is available to the customer under general law?

Remedies available to the customer include:

- Claims for damages.
- Obtaining an order for specific performance.
- Termination of the agreement.

20. What customer protections are typically included in the contract documentation to supplement relief available under general law?

Additional protections which are usually included in an outsourcing agreement include:

- Service levels to measure service performance, together with a contracted service credit or penalty arrangement.

- Audit rights in relation to service performance, legislative compliance, security issues and technical considerations.
- Extensive disengagement arrangements which are triggered on termination of the agreement.
- Contractual requirements for the supplier to maintain sufficient insurance cover to cover its liabilities and obligations under the agreement.
- Automatic rights to terminate the contract for certain events of default, including:
 - serious service level failure;
 - change of control of the supplier;
 - supplier insolvency or liquidation.
- Requesting a parent company guarantee from the supplier's ultimate parent company.
- Benchmarking provisions.
- Retaining payment to the supplier until final completion and acceptance of the relevant deliverables or services.

WARRANTIES AND INDEMNITIES

21. What warranties and/or indemnities are typically included in the contract documentation?

Typical supplier warranties and indemnities include that:

- The supplier has all the necessary rights, powers and authority to enter into and perform the agreement and the agreement is duly authorised by the necessary corporate actions.
- Service performance will meet the required levels (see *Question 20*).
- The supplier has adequate staff with the required skills, experience and expertise to render the services and who will perform the services with skill and care, in a timely and professional manner.
- IT issues are dealt with, including operating system compliance, viruses and disabling devices.
- The supplier's financial condition is such that it would not be a risk in relation to the performance of the contract.
- All relevant legal and regulatory requirements are met.
- The customer is indemnified against harm suffered as a result of the supplier, its staff and subcontractors' actions, including as a result of
 - negligence;
 - wilful or fraudulent misconduct;

- breach of the agreement;
- any infringement of a third party's IP rights.

The customer may also receive indemnities relating to personal injury, damage to property and security breaches.

Typically customer warranties and indemnities relate to:

- Being authorised and entitled to enter into the agreement and perform its obligations under it.
- Providing an indemnity in relation to third party IP infringement claims.

22. What limitations are imposed by national law on fitness for purpose and quality of service warranties?

No specific limitations are imposed.

TERM AND NOTICE PERIOD

23. Does national law impose any maximum or minimum term on an outsourcing? If so, can the parties vary this by agreement?

South African law does not impose any maximum or minimum period for any agreement and the parties are free to negotiate this. However, such agreements are usually fixed for a period of three to five years.

24. Does national law regulate the length of notice period required (maximum or minimum)? If so, can the parties vary this by agreement?

South African law does not impose any maximum or minimum notice period to terminate an outsourcing agreement and this is left to the parties to agree on in the contract. In law, if the agreement fails to mention a specific notice period, reasonable notice must be given.

TERMINATION AND TERMINATION CONSEQUENCES

25. What events are considered sufficient under national law to justify termination of an outsourcing rather than a claim in damages (for example, fundamental breach, repudiatory breach, insolvency events and so on)?

Events which would allow the termination of the agreement include:

- Repudiation by one of the parties.
- The liquidation of a party or placement of that party in judicial management, whether provisionally or finally.

- Insolvency events, including:
 - any act or omission by an individual which is an act of insolvency under the Insolvency Act 1936;
 - the existence of circumstances which would allow for the winding up of a party under section 344 of the Companies Act 1973, and/or section 68 of the Close Corporations Act 1984.

26. In what circumstances can the parties exclude or agree additional termination rights (for example, for breach, change of control, convenience and so on)?

The following additional rights to terminate are usually included in an outsourcing agreement:

- A material breach which is not capable of remedy or which is not remedied within the prescribed time period.
- The disposal by a party of a material portion of its undertaking or asset.
- A significant change of control of the supplier.
- A compromise, scheme of arrangement or composition by a party with any or all of its creditors.
- Termination for convenience by the customer on an agreed notice period. In some cases, the supplier requires compensation for early termination.

The customer should also consider the type and duration of post-termination assistance the supplier and its subcontractors must provide on termination of the agreement.

27. What implied rights are there for the supplier to continue to use licensed IP rights post-termination? To what extent can these be excluded or included by contract?

Where the customer licenses IP rights to the supplier in an outsourcing, the licence terms (either in the outsourcing agreement or a separate document) generally govern the use of those rights by the supplier post-termination and it is generally limited to the duration of the agreement.

28. To what extent can the customer gain access to the supplier's know-how post-termination and what use can it make of it?

The parties should specifically deal with the question of access to the supplier's know-how post-termination in the agreement. This is usually covered by a residual knowledge clause which allows both parties to use the generic ideas, concepts, know-how, or techniques developed or learned by them. This right is subject to the restrictions imposed in respect of the confidentiality of this information and the IP rights of the other party.

LIABILITY**29. What liability can be excluded? In particular, is it possible for the supplier to exclude liability for indirect and consequential loss and also any loss of business, profit or revenue?**

Generally, the parties are free to exclude most forms of liability. However, a contract to exclude liability for fraud is unlawful, although parties can in certain circumstances exclude liability for negligence or innocent misrepresentation.

The Consumer Protection Bill is expected to be promulgated in South Africa in 2009. Under this bill the supplier will not be able to enter into an agreement on terms that are unfair, unreasonable or unjust. Where the court finds that the agreement was unfair, unreasonable or unjust, it can, among other things, order the refund of monies to the customer and compensate the customer for its expenses.

Subject to the above, a supplier aims to exclude liability for indirect and consequential losses, and loss of business, profit or revenue, where these constitute a direct loss. In contrast, the customer usually tries to ensure that it is able to recover all its direct losses under the agreement, including direct loss of profit, business and revenue. These terms are subject to negotiation in practice.

30. Are the parties free to agree a cap on liability? If so, how is this usually fixed?

The parties can agree a limit on liability, subject to the limitations set out in *Question 29*. This can be a fixed amount, or a percentage or multiple of the contract value (for example, 125% of the contract value). In practice a percentage is generally better than a fixed sum, but this depends on the nature of the outsourcing arrangement in question and the parties' respective risk requirements.

TAX**31. What are the main tax issues that arise on an outsourcing in relation to:**

- Transfers of assets to the supplier?
- Transfers of employees to the supplier?
- Value added tax (VAT) or the equivalent sales tax on the service being supplied?
- Other significant tax issues?

Transfers of assets to the supplier

Assets can either be sold to the supplier or the supplier can be given the right to use the assets for the duration of the outsour-

ing contract. The sale of a depreciable asset by the customer to the supplier results in a taxable gain for the customer, if the proceeds exceed the tax value. Where the proceeds do not exceed the tax value, the customer is entitled to deduct a scrapping allowance.

Where the supplier is given the right to use a customer's assets in return for a reduced fee, the reduced fee qualifies for a deduction. The same result is achieved where an amount is paid by the supplier for the use of the asset and a fee without reduction is charged.

Transfers of employees to the supplier

Where the supplier becomes the new employer and assumes responsibility for employee's remuneration, the employees' tax (PAYE) obligations are also transferred. The supplier is obliged to withhold PAYE, including Unemployment Insurance Fund (UIF) contributions. Employers are also liable to contribute a Skills Development Levy (SDL) calculated as 1% of remuneration, which is not deducted from the employee's pay. The PAYE and UIF contributions, including the SDL liability must be paid to the South African Revenue Service within seven days of the end of the month during which the remuneration was paid.

VAT or sales tax

The outsourcing fee charged by the supplier is generally regarded as a taxable supply for VAT purposes. VAT can only be charged and claimed by registered VAT vendors. Where the customer makes VAT exempt supplies (generally in the financial services sector) input tax cannot be claimed, resulting in a VAT cost to the customer.

Other

There are no other significant tax issues.

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