



MUST KNOWS FOR ENGAGING CONTRACT LABOR IN INDIA

By Sunil Tyagi & Namrata Wadhawan

To meet their staffing needs in India, many businesses, both domestic and foreign, engage contract labor for the scalability and flexibility it provides in managing human resource and head count. This approach raises several legal compliance issues that must be dealt with both up-front and on an ongoing basis. This article provides a road map for managing the legal and regulatory risks of engaging contract labor.

WHAT THE LAW PERMITS

In a nutshell, the Contract Labour (Regulation & Abolition) Act, 1970 (the "Act") permits companies and establishments (the "Employer(s)") in the manufacturing and services sectors to engage contract labor through contractors for performing tasks that do not form part of the "core" operations. Core operations are those activities for which a company or establishment has primarily been established. The Act allows the Government to prohibit Employers from employing contract labor in any of its core process or operations. The Government, prior to issuing a prohibitory notification for engaging contract labor in any process evaluates whether –

- (a) the process or operation is incidental or necessary for the Employer;
- (b) the work performed by contract labor is permanent in nature;
- (c) such process or work is ordinarily performed by regular employees of other similar Employers; and
- (d) sufficient number of whole-time employees can be deployed to perform the work.

By engaging contract labor in the incidental activities, Employers can concentrate on developing their core competencies and non-core activities are performed by contract labor whose management is in the hands of contractors who employ and control them.

APPLICABILITY OF THE ACT

The Act is applicable to every Employer or contractor who employs or has employed 20 or more contract laborers on any day during the previous twelve months. The Employer is treated as a single unit without reference to the nature of work that is being executed by the contract labor. The workmen include any person who is employed by a contractor to work in a company or establishment to perform any skilled, semi-skilled or unskilled manual supervisory, technical or clerical work.

For example, if a Company X, an IT company, has executed a contract to provide certain services (say call center or development of certain software) to its client for which Company X requires about 40-50 people to complete the project. The term of the contract is 1 year. However, Company X already has more than 300 employees and does not want to increase its head counts by engaging 40-50 people for performing the contract. It decides to outsource the entire contract to another service provider whose employees' will provide the services at the site of Company X while Company X will provide the entire infrastructure required to perform the said services. Such arrangements/contracts come within the purview of the Act. However, people employed in managerial or administrative positions are outside the ambit of the Act as they work on contracts directly executed between them and their employer.

The Act is not applicable if the work performed by a contract labor is of a sporadic nature. It is the Government that decides if the work is of a casual or intermittent nature and its decision regarding the same is final. Basically, any work performed for more than 120 days in a year in a company or establishment is not considered as work of an intermittent nature. Consequently, contract labor is usually engaged by the Employers for performing support services such as security, catering, courier, construction and maintenance, gardening, house keeping, transport etc.

COMPLIANCES UNDER THE ACT

The Act requires both the “principal employer” and the contractor to fulfill their respective statutory obligations. Principal employer is the one who employs contract labor through a contractor. “Contractor” in relation to an Employer means a person who – (a) undertakes to perform a job for the Employer through contract labor other than mere supply of goods or articles of manufacture; or (b) supplies contract labor for any work of the Employer & includes a sub-contractor.

In case of a factory, any one of the “owner”, the “occupier” or the “manager” (as per the Factories Act, 1948) is considered a principal employer whereas, in case of a company or establishment, the person who is in control and supervision of such company or establishment is considered to be the principal employer.

As per the Act - (a) the Employer must be registered with the authorities; and (b) the contractor must have a valid license from the authorities prior to engaging contract labor.

In the case of *Workmen of Best & Crompton Industries Ltd. v. Best & Crompton Industries Ltd.*, the Madras High Court held that the principal employer must engage contract labor through a contractor who has a valid license, because an invalid license of a contractor would imply direct employment of contract labor by the principal employer. The license issued by the authorities is job specific, and cannot be transferred for any other job and is indicative of the

number of contract laborers a contractor can employ for a given job.

The contractor is responsible for providing all statutory benefits to contract labor and if he fails, the obligation falls on the principal employer. The Supreme Court in *People’s Union for Democratic Rights v. Union of India* held that if the contractor fails to fulfill its duties under the Act then the principal employer is under an obligation to provide all amenities and benefits prescribed under the law to contract labor deployed at its establishment. The principal employer must witness disbursement of wages to the contract labor by the contractor (who is essentially the employer of the contract labor). If the principal employer steps in on behalf of the contractor to provide facilities and benefits to the contract labor then such a principal employer is entitled to recover the money spent, from the contractor. Non-compliance with provisions of the Act can lead to imposition of monetary & penal sanctions.

GUIDELINES FOR ENGAGING CONTRACT LABOR

While engaging contract labor, the Employers must execute contracts with the contractors and such agreements must clearly define the terms of engagement of the contract labor.

The Employer must ensure that it does not appoint one of its own employees’ as a contractor through whom it engages contract labor. In case of a dispute between contract labor and principal employer, the courts may lift the veil to ascertain the intent of the management and/or check genuineness of such an agreement. If the principal employer is employing and controlling the contract labor through its own employee posing as a contractor then the principal employer is, without actually increasing its head count, controlling the contract labor. In the case of *Indian Petrochemicals Corporation Limited v. Shramik Sena*, the Supreme Court held that such contracts are sham and bogus and are liable to be set aside.

The Supreme Court in *Haldia Refinery Canteen Employees Union & Others vs. Indian Oil Corporation Limited* laid down certain guidelines for engaging contract labor:

- Principal employer must not interfere with the contractor for engaging contract labor. Contractor must have free hand to engage its employees;
- Wages should be disbursed by the contractor, principal employer must not have any direct role to play except deploy its representative in whose presence salaries are distributed by the contractor to the contract labor (as required under the Act);
- Contractor is liable to pay all statutory benefits such as provident fund contributions, leave salary, medical benefits, and observe statutory working hours for its employees. Principal employer should avoid managing the contract labor;
- Contractor is responsible for proper maintenance of registers, records and accounts for compliance with statutory provisions/obligations;
- Contractor should maintain records of payments of wages etc. and for deposit of provident fund contributions with authorities;
- Contractor is liable to defend/indemnify the principal employer from any liability or penalty which may be imposed by State/Government authorities for any violation by the contractor of such laws, regulations and also against all claims, suits or proceedings that may be brought against the principal employer arising under or incidental to or by reason of the work provided/assigned under the contract brought by the employees of the contractor, third party or Government authorities.

The Supreme Court in the case of *Hindalco Industries Ltd. vs. Association of Engineering Workers* observed that - (a) the workmen were employed for long years and despite a change of contractors the same workers continued to be employed at the establishment and; (b) there was evidence on record to establish the ultimate control of management on

such contract employees. Under such circumstances, the Court would be entitled to pierce the veil and arrive at a finding that the justification relating to appointment of a contractor is sham or nominal and in effect and substance there exists a direct relationship of employer and employee between the principal employer and the workmen.

The principal employer has a right to assess the abilities and skills of the workers employed by the contractor to ensure the quality of service provided under the contract, without actually managing or directing such contract labor. While engaging contract labor, the principal employer must abstain from – (a) controlling their appointment and terms of appointment; (b) controlling them directly or indirectly; (c) taking disciplinary action; (d) supervising their work directly; and (e) dismissing or removing contractor’s employees from service. The principal employer must only exercise a supervisory role to ensure that well qualified & capable people render the required services properly. The principal employer should communicate with the contractor only.

ABSORPTION OF CONTRACT LABOR

As stated above, the Act empowers the Government to prohibit employment of contract labor in any process, operation or other work in any company or establishment. Once the appropriate Government issues a prohibitory notification banning engagement of contract labor, it will not be possible for an Employer to engage contract labor on that job, process or operation. The Supreme Court in the case of *Air India Statutory Corporation v. United Labor Union* held the view that if a prohibitory notification has been issued by the Government then contract labor engaged in those prohibited activities would be considered the direct employee of the principal employer and shall acquire a right to automatic absorption into the service of the principal employer.

In a subsequent judgment of *Steel Authority of India Limited v. National Union Water Front Workers* (“SAIL Judgment”), Supreme Court set aside the Air India judgment. In the SAIL judgment, the Supreme Court held that prohibition notification issued by the Government does not mean automatic absorption of

contract labor in a company or establishment. It is essential that the court must consider the terms of a contract to establish if the contract under which the labor is appointed for work is a genuine contract or is a mere ruse/camouflage to evade compliance with the provisions of the Act. If it is found that the contract is a camouflage then contract labor must be treated as an employee of the principal employer who will have to regularize such contract labor. However, if the contract is genuine then the principal employer at its own discretion can employ contract labor as a regular employee by giving them preference over others. But under no circumstances, is the principal employer under any obligation to absorb contract labor on its rolls if employment of contract labor in certain activities is prohibited by the Government authorities.

Consequently, certain ancillary jobs in a company or establishment can be performed by the contract labor engaged through contractors provided the Government has not banned their employment on those jobs and they are given all their statutory benefits. Although contract labor is an effective way for an Employer to have access to additional human resource without increasing its head count, it is pertinent to understand the finer nuances of engaging

contract labor and the related law prior to engaging contract labor so as to avoid unwarranted disputes with them.

Sunil Tyagi is a Senior Partner and Namrata Wadhawan a Senior Associate at ZEUS Law Associates. ZEUS is a corporate commercial law firm based in India. One of its areas of specialization is employment law related transactional and litigation work. Sunil and Namrata can be contacted at sunil.tyagi@zeus.firm.in and namrata.wadhawan@zeus.firm.in.