# Setting up business in India: know your basic employment law issues

## Introduction

Regulation of employment matters in India is generally covered by both central and states' laws. The relationship between an employer and employee is regulated by contract law. Generally speaking, the framework of Indian labor law differentiates between an employee and workman, the latter being equated to a blue-collar worker. The provisions relating to working conditions also vary depending upon whether the establishment in question is a factory, a shop or other kind of commercial establishment. A key component of managing industrial relations well is to strike a balance between terms of employment and conditions of labor of the workmen and employees versus management expectations. Given the socialist leanings in India, discontented workmen can potentially become a powerful and a disruptive force. Thus, Indian labor law involves balancing complex relationships between the workers, employers and government. As a matter of a universal principle, maintaining plant and workmen harmony cannot be overstated.

This newsletter aims to provide an overview of certain key issues under existing applicable law which has to be borne in mind by an entity operating in India, be it for blue or white-collar workers.

## 1. Regulatory Framework

The host of legislations includes Industrial Disputes Act,[1] (**"the ID Act"**) Industrial Employment (Standing Orders) Act,[2] the Trade Unions Act,[3] Contract Labor (Prohibition and Regulation) Act, Payment of Wages Act, Minimum Wages Act,[4] Equal Remuneration Act[5] as well a vast variety of social benefits legislations like Gratuity Act, Payment of Bonus or Employees Provident Fund Act.[6] Working conditions of workmen are regulated by the Factories Act or the Shops and Establishments Act in force in the relevant State and depending on the nature of the industrial establishment, i.e. a shop, a factory undertaking manufacturing activities and typically include hours of work, leave, conditions and maintenance of place of work which are covered also in the employee manual. The Employees

[1] This law provides for the procedure for investigation and settlement of industrial disputes.
[2] The Standing Orders contain conditions of employment and must be defined precisely. The employers in industrial establishments must communicate such conditions to the employees.
[3] This law provides for the registration and protection of trade unions formed to regulate relations between employer and employees.
[4] This provides for the legal minimum amount of wages to be paid in certain sectors that are generally unorganized.
[5] The act provides for payment of equal remuneration to men and women employees and for the prevention of discrimination on the ground of sex against women in employment.
[6] It provides for the institution of provident funds, pension fund and deposit linked insurance funds for employees in establishments.

State Insurance Act provides certain benefits in the case of sickness, maternity and employee related injury.

The foregoing is not an exhaustive list, but covers most of the applicable law governing any employment. In addition, the terms of the actual employment contract are equally important when hiring in India.

## 2. Important Considerations and Commonly Raised Questions

Some of the key aspects emanating from hiring, confronted commonly in India, are covered below. Some apply only to manufacturing establishments, while others are equally relevant for service companies i.e. where there is no manufacturing activity.

### *Contract Labor*

The Contract Labour (Prohibition and Regulation) Act provides the mechanism for regulating engaging of a contractor and contract labor. If more than twenty workers are engaged, the contractor must be registered. Additionally, the law also provides for appointment of a Tripartite Advisory Board (**"TAB"**) which investigates particular forms of contract labor. If TAB finds that contract labor is engaged in areas requiring perennial work connected with the production process then it could recommend its abolition. A tricky legal question surrounds contract labor who come within the ambit of the definition of "workman" as provided in section 2(s) of the ID Act and can raise industrial disputes in case of any grievance. The general leaning of the courts is that prior to looking into the merits of a case, the threshold issue to be verified is whether a person qualifies as a workman as per ID Act. This can be determined from the contract, but more importantly, from the nature of duties performed. Generally, contract laborer engaged for a particular period with a defined job does not qualify as a *workman* under the ID Act. Such an individual is governed by the terms of contract between the contractor and the Company. The courts have consistently held that if the principal employer keeps control on contract labor including granting them leave or extending any salary advance then the contract between contractor and principal employer is a sham. Both the contractor and contract labor can be considered an employee of the principal employer.

On April 13, 2009 the Supreme Court of India held that the ultimate supervision and primary control over contract labor is held by the contractor, and the employer only has secondary control over them because only the contractor is empowered to decide *where* the worker will work, and *duration* and *conditions* of the work. In this case, the Court did not permit the contract labor to claim benefits similar to that of the employee. However, different courts have viewed the situation differently and while no generalization is possible, the test to determine whether a contract labor qualifies as an employee is to evaluate who have been directly (1) paying the wages, (2) taking penal action against them, and (3) exercising direct control and supervision. From the foregoing, it is important to bear in mind that the risk of a contract laborer potentially seeking an employee status does exist. The triggers for potential industrial disputes for this category can arise in the following circumstances:

- Tendency/frequency to hire workers who are engaged in activities contrary to any local notification prohibiting employment of contract labor. Non-compliance with provisions of legislations which require employers to provide benefits to its employees including contract labor.
- Excessive control/check on the activities of contract labor.

Companies should ensure that the contract labor should not be involved in production activities, they should avoid direct control over them and always approach the contract workers' through the contractors and in accordance with the contract with such contractors.

### *Restrictive covenants in employment contracts*

Indian law is very clear on the principles of non-compete, and tends to be pro-employee. Section 27 of the Contract Act states that every agreement by which a person is restricted from exercising a lawful profession, trade or business of any kind is void to that extent. There is no exception in relation to employment contracts. Section 27 does not validate any restraint on trade, even if it is reasonable. This stems from the fundamental right of every person to practice any trade or profession. As far as employment contracts are considered, courts have allowed restrictions on competition from the employee during the term of employment, unless the restrictions favor the employer intensely. Further, an employer can lawfully prohibit his employee from accepting, after cessation of his employment, such a position where the employee is likely to utilize the proprietary rights of the employer acquired during the course of employment. However, an employer cannot restrain the employee, after expiry of employment, from taking up employment elsewhere or setting up his own business that involves utilization of the skills and knowledge gained during the course of employment.

The employer is only protected against misuse of his proprietary rights, and not against competition. Despite this, companies have not stopped from imposing non-compete restrictions that operate after the expiry of employment, as more often than not they act as a psychological deterrent. In order to curb this practice and prevent employees joining the competitors, a potential option is to have the employee execute a "bond" at the time of their joining the company. This is basically an agreement between the company and the employee which compels the employee to pay a sum of money to the company if he leaves before the expiry of a certain specified and a mutually agreed period. A financial sanction will have some level of greater "force" even though recovery of the money is not an easy process. Given the common law background on which Indian law is premised, each case is looked at its own special facts. Should supervening circumstances exist which enable a court to grant a relief to an aggrieved employer, but if restrictive covenant is absent from the employment contract, securing a relief shall be challenging, if not impossible. The Indian trend is that usually the courts have granted compensation only if the company has actually suffered a loss as a result of the employee joining a competitor. Generally, the courts will not grant an injunction that will force the employee to either work for a particular employer or remain idle.

### *Termination of employment and statutory requirement for severance payments*

Employees may be taken on probation for a period of 2-6 months, depending on the company practice. Such probationary employees may be terminated with appropriate notice without providing any reason. In case of confirmed employees, termination would have to conform with the provisions of the Industrial Disputes Act which provides for a minimum notice period and for retrenchment compensation which equals 15 days average pay for every completed year of continuous service. This is not applicable to managerial and supervisory employees.

Apart from social benefits payable at the time of termination of employment (gratuity and provident fund) a workman may be entitled to receive retrenchment compensation described above if the employment is terminated for any reason, provided the termination is not due to disciplinary proceedings, voluntary retirement, superannuation, etc. The amount of retrenchment compensation is calculated on the circumstances of each case and the relevant criteria includes the nature of the undertaking in which the employee is employed, the salary of the employee and duration of the employment.

## Conclusion

Reforms in Indian labor law are the subject of a lot of debate. Liberalization without the corresponding labor reform could be short-lived. Reforms need to focus on several areas, but a few of them can be (a) reduction in the disproportionate number of adjudicating authorities at multiple levels, be they conciliation officers, conciliation boards, courts of inquiry, labor courts, industrial tribunals and the national industrial tribunal, all of which are under the Industrial Disputes Act; (b) simplification of the complex procedures which are out of sync with the India of the 21st century that needs to take its rightful place on the global centre-stage; (c) tools to bridge the gap between the employer and the employees so that the latter treat themselves as stakeholders and work with continuity leading to lower attrition rates. It is our belief that these are the very minimum pre-requisites for the success of Indian companies that need to survive and march ahead in a flat world.

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