

## LEGAL CHALLENGES WHILE TERMINATING YOUR EMPLOYEES IN INDIA

The Indian economy currently witnesses the second largest labour force across the globe. The gigantic growth in the population of workers has from time to time pushed the law makers towards structuring of several employment legislations in India, finally resulting into one of the most bulky labour law regime. Though, the history of labour laws in India may be traced in the era of British colonialism, the existing regime has been significantly shaped up during the post-independence period. Besides the efforts made by Indian legislatures, the influence of international conventions and recommendations made by organisations like 'International Labour Organisation' played a vital role in carving up of the current legislative framework.

Being a concurrent subject in the Constitution of India, both union and each of the state governments have been empowered to act as legislators in relation to the labour and industrial matters. This has in turn resulted into more than fifty central enactments besides the enormous number of legislations enacted by respective state governments.

Amongst others, one of the most significant rights of employers in India i.e. to draw and implement their own 'hire and fire' policy is not absolute in nature and witnesses plenty of interference on account of the said legislative framework, especially those pertaining to termination of employees. This article makes an attempt to throw a light on the legal issues / challenges faced by employers in India while terminating their employees.

### Workman versus Non-workman

The Industrial Disputes Act, 1947 ("IDA") is the key federal statute that governs industrial relations in India and *inter alia* includes provisions that regulate the industrial disputes and governs the rights and obligations of an employer and employee in the event of termination of employment. However, termination of an employee on account of misconduct has specifically been excluded from the ambit of the IDA. Indian labour laws make a distinction between an employee who is categorized as a 'workman' and the 'non-workman'. IDA is only applicable to workmen. Employees that primarily discharge (i) administrative or managerial functions or (ii) those rendering supervisory functions **and** earning more than the prescribed threshold (Rupees ten thousand per month) are not considered to be workmen. The courts in India have clarified that the term 'supervision' herein refers to supervision over other person and not supervision upon things/objects. Further, it is not the nomenclature of an employee, but the nature of work being performed by

him which shall be taken into consideration to determine whether an employee is workman or a non-workman. The Supreme Court of India has further observed that the question, whether a person is employed in a supervisory capacity or on clerical work, depends upon whether the main and principal duties carried out by him are those of a supervisory character, or of a nature carried out by a clerk. If a person is mainly doing supervisory work, but, incidentally or for a fraction of the time, also does some clerical work, it would have to be held that he is employed in supervisory capacity; and, conversely, if the main work done is of clerical nature, with the mere fact that some supervisory duties are also carried out, incidentally or as a small fraction of the work done by him will not convert his employment as a clerk into one in supervisory capacity.

The IDA grants certain special protections to workmen as compared to the non-workmen in case of termination of their employment, specifically in the event of (i) 'retrenchment' i.e. termination by the employer of the service of a workman for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action; (ii) 'lay-off' i.e. failure, refusal or inability of an employer (on account of shortage of coal, power or raw materials or the accumulation of stocks or the breakdown of machinery or natural calamity or for any other connected reason) to give employment to a workman whose name is borne on the muster rolls of his establishment and who has not been retrenched; and (iii) 'closure' which simply means the permanent closing down of a place of employment or part thereof.

Further, the Industrial Employment Standing Orders Act, 1946 ("IESO") which standardises the working conditions of a workmen lays down the procedures for conducting disciplinary proceedings in relation to acts of misconduct by a workman. Though, the said enactment applies to such industrial establishment (including factories) wherein one hundred or more workmen are employed, it is generally advisable to adopt the principles laid down under IESO for conducting a disciplinary proceeding against an employee prior to terminating him, in the event the organisation has not laid down any specific mechanism for conducting such internal proceedings.

#### Termination of Non Workmen

In case of non-workmen, the terms and conditions of employment are governed by their contract of employment with the employer. Thus, terminations of non-workmen employees will be governed by the contract of employment entered into with the employee concerned read with the applicable provisions of the employment handbook of the employing entity.

Further, In India, every state has its independent Shops and Commercial Establishments Act ("S&EA") which regulates the conditions of work in shops and

commercial establishments, which governs the service conditions of employees including those relating to termination. Almost under all the S&EA, an employee is entitled to notice of one month or wages in lieu of notice if the employer wishes to dispense with the services of that employee except in case of misconduct. Where an employee's services are terminated on account of misconduct, an employee is not entitled to any notice or payment in lieu thereof. Generally, the said enactments define misconduct to include acts of theft, fraud, misappropriation or dishonesty in connection with the employer's business or property.

Given the aforesaid, it is a settled legal position in India that in the event the terms and conditions of an employment contract between the employee and employer are more favourable to the employee than a prescribed statutory benefit, the terms of such a contract will prevail over the statutory provisions. Therefore, in the event the employment contract provides for a notice period of more than one month, the terms of such contract shall prevail. The said principle has also been recognised under most of the S&EA. For instance, the Bombay Shops and Establishments Act, 1948 provides that *"nothing in this Act shall affect any right or privileges which an employee in any establishment is entitled to at the date this Act comes into force in a local area, under any other law, contract, custom or usage applicable to such establishment or any award, settlement or agreement binding on the employer and the employee in such establishment, if such rights or privileges are more favourable to him than those to which he would be entitled under this Act"*.

In addition to the said statutory requirements, the internal policies as provided in the policy statements / handbook in relation to termination and disciplinary proceedings must be complied with. Case law has clarified that *'an employee handbook or other policy statement creates enforceable contractual rights if the traditional requirements for contract formation are present. First, the language of the policy statement must contain a promise clear enough that an employee would reasonably believe that an offer has been made. Second, the statement must be disseminated to the employee in such a manner that the employee is aware of its contents and reasonably believes it to be an offer. Third, the employee must accept the offer by commencing or continuing to work after learning of the policy statement. When these conditions are present, then the employee's continued work constitutes consideration for the promises contained in the statement, and under traditional principles a valid contract is formed.'*

#### Termination of management personnel

Unlike other employees in India, the termination of personnel holding position in the management of a company i.e. those being members of board of directors of a company is not governed solely by the labour and industrial laws. In order to terminate a person from the board of a company (both private and public), the company as on date needs to comply with the procedure prescribed under (i)

Section 169 [other than sub-section (4)] of the Companies Act, 2013 read with sub-section (4) of Section 284 of the Companies Act, 1956.

As per the said statutory provisions, the company needs to obtain a notice from member/s of the Company proposing the resolution for removal of the personnel from the position of the Director (“**Special Notice**”). In view of the recent amendments introduced vide the Companies Act, 2013 the Special Notice required to be given to the Company is required to be signed, either individually or collectively by such number of members/shareholders holding not less than one per cent of total voting power or holding shares (of the Company) on which an aggregate sum of not less than five lakh rupees has been paid up on the date of the notice.

In accordance with the said provisions such a director may only be terminated in course of a general meeting of the company, where the said director needs to be given an opportunity to be heard.

#### Conclusion

Though the terms and conditions agreed between the employer and employees by way of their respective employment contracts govern their relationship, however, law makers have ensured that the employees (especially workmen) are not subjected to harsh and unreasonable terms on account of lack of negotiating position. In view the same, the legislative framework governing their employment and termination have specifically been provided an overriding effect with respect to the provisions contained in their employment contracts. Any non-compliance by an employer of any statutory obligation while terminating its employee may nullify the termination or allow the employee to be reinstated. Hence, it is very important that an employer accurately identifies and complies with all such laws.

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## Supreme Court on Territorial Jurisdiction under Section 138 of the Negotiable Instruments Act

### Overview

*K. Bhaskaran v Sankaran Viadhyan Balan*<sup>1</sup> (*Bhaskaran*) is one of the oldest decisions on the interpretation of Section 138 of the Negotiable Instruments Act, 1881 (Act). It laid that the offence under section 138 was a concatenation of five necessary elements including:

(1) Drawing of the cheque;(2) Presentation of the cheque to the bank;(3) Returning the cheque unpaid by the drawee bank;(4) Giving notice in writing to the drawer of the cheque demanding payment of the cheque amount;(5) Failure of the drawer to make payment within 15 days of the receipt of the notice.

As per section 177 of the Criminal Procedure Code (CrPC), territorial jurisdiction to be determined on the basis of the 'place of offence'. In other words, the emphasis is on the place where the offence is committed. Since *Bhaskaranlays* down 5 elements, all of which together constitute the offence, territorial jurisdiction could be granted to any territory wherein any of the 5 necessary elements were given effect. In simpler terms, a complainant under section 138 could choose any territory wherein any of the requisite elements of the offence took place.

### **The new landmark: Dashrath Rupsingh Rathod v State of Maharashtra & Anr.2(Dashrath)**

The *Dashrath* judgment makes a distinction between elements leading to the commission of offence and the elements required for prosecution under section 138 of the Act. As per *Dashrath*, the offence contemplated under section 138, is the dishonour of cheque alone. It elaborates that the provisos under section 138, are elements that enable the prosecution of the offence under section 138. Thus, the notice requirements post the dishonour of cheques and any non-compliance thereof no more constitutes the offence under section 138, these are elements that enable only prosecution under section 138.

Importantly when this interpretation is read with section 177 of the CrPC, it takes away the choice that the complainant previously enjoyed in terms of choosing the venue for filing the complaint. The territorial jurisdiction is now limited only to the place where the dishonour of cheque occurs i.e. where the drawee bank is located.

### **Analysis by Court**

The Hon'ble Supreme Court did a detailed and thorough analysis of the legislative intent, judicial trend and the factual matrix concerning section 138 to come to the current conclusion.

Following are some of their prime considerations:

#### **1. The legislative intent behind s.138 of the NI Act**

The Indian Penal Code (IPC) already contained criminal sanctions for dishonour of cheques. However, a successful action under the IPC required the proof of a dishonest intention on the part of the drawer of cheques. The parliament wanted to provide a remedy for dishonour of cheques which was free from the element of *mens rea* and thus came the remedy under section 138 which does not require the complainant to prove a dishonest intention. All it requires is to prove the commission of the offence which is the dishonour of a cheque whether or not the element of *mens rea* is present or not. The provisos under section 138 are included only to protect cases where the offence has been committed by any inadvertent mistakes. However, there is no doubt that the offence for which the defenses have

been provided is the dishonour of cheques alone.

## 2. The judicial trend

The Supreme Court analysed a plethora of judgments including its own and came to the conclusion that section 138 of the NI Act, was to be read in terms of being 'accused centric' rather than being 'complainant centric'. Decisions like *Harman Electronics Pvt. Ltd. v National Panasonic India Pvt. Ltd.*<sup>3</sup> and *Ishar Alloy Steels Ltd. v Jayaswals Neco Ltd.*<sup>4</sup> were sufficient for the apex court to hold that the cause of action could not be determined by any omission or commission on the part of the 'complainant'.

## 3. The factual matrix

Post *Bhaskaran*, section 138 was being rampantly misused across the country insofar as territorial jurisdiction for the trial of the complaint was concerned. The court observed that legal instruments must not be used as a device for harassment, even of an apparent transgressor of the law.

## 4. Criminal jurisprudence

The Supreme Court was rightly convinced there is a discernibly demarcated difference between elements required for the commission of an offence and the elements required for its cognizance leading to prosecution and that both these elements were present together under section 138 of the Act.

## 5. The applicability of the decision

The Hon'ble Supreme Court of India was aware and responded to the impact that the current decision would have on various cases pending before various courts across the country.

It held that cases where recording of evidence had commenced under section 145 (2) of the Act would continue to take place from wherever the complaint had been filed previously. However, cases that had not reached up to the stage of recording evidence under section 145 (2) were maintainable only at the place where the cheque stood dishonoured. In simpler terms, the judgment is prospective in nature.

1. (1999) 7 SCC 510
2. Criminal Appeal no. 2287 of 2009, Decided on 01.08.2014
3. (2009) 1 SCC 720
4. (2001) 3 SCC 609

Securities Exchange Board of India (SEBI) enacted the Alternate Investment Fund Regulations (“AIF Regulations”) to regulate Funds established in the form of Companies, Trusts and Limited Liability Partnership firms or other body corporate. The AIF Regulations classifies AIFs in three categories depending on the nature of the investment and the structure of the fund. *Category-I* AIFs include venture capital funds, SME Funds, social venture funds, infrastructure funds which primarily invest which invests in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable. *Category-II* AIFs do not undertake leverage or borrowing other than to meet day to day operational requirements and include private equity and debt funds. *Category-III* AIFs employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives such as hedge funds.

Under section 10(23FB) read with 115U of the Income Tax Act, venture capital funds (under Category-I AIFs) were not liable to pay tax at the fund level and this income was taxed at the hands of the investors as if such persons directly invested in the venture capital undertaking. In this regard, venture capital companies faced certain hurdles as they were subject to dividend tax. However, venture capital funds in the form of trusts in Category-I had a total tax pass through i.e., they were exempt from tax liability at the fund level and hence, they were considered the most favourable structure for creating funds.

Further taxation of trusts depends upon whether the trust is determinate or not. Determinate trusts can avail of the benefit of a total tax pass through. For the purpose of applying the provisions of the Income Tax Act, it is essential to first decide the nature of the trust being dealt with. For this purpose determinate trust is one where the names of the investors and their beneficial interest have been specified in the trust deed on the date of creation of the trust.

The Central Board for Direct Taxes (CBDT) vide its Circular dated 28th July, 2014 has examined the tax regulations applicable to AIFs in the form of non-charitable trusts where the name of the investors and their beneficial interests are not explicitly known on date of the creation of the trust. The CBDT has issued certain clarifications as regards the taxation of AIFs in the form of non-charitable trusts. The said Circular has created widespread speculation among the affected sectors.

The Circular has been briefly discussed hereinbelow:

- In case of an indeterminate trust which does not mention the names of the investors or their beneficial interest on the date of creation of the trust, the whole income of the trust will be taxed at the Maximum Marginal Rate in the hands of the Representative Assessee in accordance with sub-section (1) of section 164 of

the Income Tax Act. Consequently, section 166 of the said Act will not apply and the income will not be taxed at the hands of the investors.

- In case of a determinate trust where the whole income of the trust is inclusive of profits and gains of the business, the whole income of the trust will be taxed at the Maximum Marginal Rate of tax under section 161 (1A) of the said Act.
- The Circular also states that the contents thereof will not be applicable in the area falling in the jurisdiction of a High Court which has taken or takes a contrary decision.

The above Circular is likely to drastically affect funding in case of onshore funds as most AIFs in India are in the form of non-charitable trusts.

## News 10 @ a glance

### **E-Filing of Copyright Applications made mandatory**

As per Notification – No. F. 27-25/2014-CP (dated 22nd July, 2014), the Indian Copyright Office has made it mandatory for all Copyright Applications to be filed online. Physical filing of Copyright Applications would no more be possible as the Copyright Counter would not function post 1st August, 2014. The guidelines for filing the online application are available [here](#).

### **Provision for Private Placement of Non-Convertible Debentures amended**

The Ministry of Corporate Affairs vide its notification dated 30th June 2014, inserted a second proviso to sub rule 2 of Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 under the Companies Act, 2013.

As per the extant rules when an



offer or invitation for Non Convertible Debentures was made under section 42 of Companies Act, 2013, a single special resolution for approving such offer/invitation, passed previously by the company was sufficient to cover all such offers made in that year. However, post the Amendment, offers or invitation made within six months of the enactment of the Companies Act require a special resolution to be passed by the company within six months of the commencement of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

### **RBI restores the limit for Overseas Direct Investments.**

The RBI vide its Circular dated 14th August, 2013 had reduced the limit of Financial Commitment of Indian Parties in Overseas Direct Investments to 100% of the Net Worth of the Indian Party. Any ODI in excess of 100% of the net worth was considered under the Approval Route by the Reserve Bank of India. The limit prior to the said Circular was 400% of the net worth of the Indian Party. The limit existing prior to said Circular has been restored by a Circular released by the RBI on 3rd July, 2014. However, as per the notification any Financial Commitment exceeding USD 1 (one) billion (or its equivalent) in a financial year would require prior approval of the Reserve Bank even when the total Financial Commitment of the Indian Party is within the eligible limit under the

automatic route (i.e., within 400% of the net worth as per the last audited balance sheet).

### **RBI issues a Master Circular on Direct Investment by Residents in Joint Ventures/Wholly Owned Subsidiaries (WOS) abroad**

The Reserve Bank of India issued a Master Circular on 1st July, 2014 which consolidates all existing instructions on the subject of Direct Investment by Residents in Joint Ventures/Wholly Owned Subsidiaries abroad.

### **Clarifications on the definition of 'Related Party Transactions'**

The Ministry of Corporate Affairs issued a clarification on the 5th clause of the Definition of 'Related Party Transactions' vide Companies (Removal of Difficulties) Fifth Order, 2014 dated 9th July, 2014. The Order substitutes the word 'and' for 'or' in the 5th clause of the definition. The confusion was with respect to the definition of Related Party with reference to a Company. The clause that was amended previously led to the conclusion that any Public Company in which the Director or Manager was either a Director or held 2% of its paid up capital, along with his relatives, was a Related Party. Now, a Public Company in which the Director or Manager is a Director and holds 2% of its Paid Up capital along with his relatives is a Related Party.

The MCA further issued Companies (Removal of difficulties) Sixth Order, 2014 in order to amend and clarify the definition of a Related Party.

The word 'relative' has been inserted in clause 4 of the definition. Previously, a Private Company in which a director or manager was a member or director was a Related Party. Post the Amendment, a private company in which a director or manager or any of their relatives are members or directors are Related Parties.

The MCA also amended Rule 3 of the Companies (Specification of definitions details) Rules, 2014 excluding independent directors from the purview of section 2 (76) (ix) of the Act and the definition of 'Related Party'.

### **RBI amends Reporting procedures for FDI**

Indian Companies are required to report the issue of shares, convertible debentures, partly paid shares and warrants as per Form FC-GPR. Form FCTR is required for the transfer of shares, convertible debentures, partly paid shares and warrants by way of sale from a person resident in India to a person resident outside India or vice versa. Both these Forms require the mention of the National Industrial Classification (NIC) Codes. The DIPP vide its Press Note 4 (2014 Series) dated 26th June, 2014 adopted NIC 2008, doing away with NIC 1987. The reporting

requirements under FC-GPR and FCTR require the mention of NIC Codes. RBI vide its Circular dated 18th July, has mandated the usage of NIC 2008 for the purposes of meeting reporting requirements under FC-GPR and FCTR. The RBI has also introduced State Codes and District Codes for the said purpose.

**IRDA issues guidelines for insurers to become proprietary trading members of SEBI approved stock exchanges.**

The IRDA on 10th July, 2014 issued guidelines for insurers to become proprietary trading members of SEBI approved stock exchanges.

These include:

- 1) Insurer needs to ensure compliance of all Regulations and guidelines prescribed by SEBI and other regulatory agencies as amended from time to time in this regard.
- 2) Operations pertaining to Membership for Corporate Bond segment in SEBI approved Stock Exchanges for undertaking their proprietary trades should facilitate separate monitoring of such trading transactions by maintaining separate Bank and Demat accounts.
- 3) Insurers are required to note that any penalties arising out of such membership shall not be debited to Policyholder's account.
- 4) Concurrent auditor has to comment on non-compliance, if any, arising out of membership of stock

exchange for proprietary trading in his quarterly audit report.

5) The decision to obtain Membership shall be taken by Board of Directors.

### **MCA clarifies position on section 203 (1) of the Companies Act, 2013**

The Ministry of Corporate Affairs issued a clarification that public companies that have a paid-up share capital of rupees one hundred crore or more and have an annual turnover of rupees one thousand crore or more and which are engaged in multiple businesses and have appointed a Chief Executive Officer for each such business shall be the class of companies covered under the second proviso to sub-section (1) of section 203 of the said Act.

### **RBI issues a Master Circular on Compounding of Contraventions under FEMA, 1999**

The Reserve Bank of India issued a Master Circular on 1st July, 2014 which consolidates all the existing instructions (Circulars, Notifications) on the subject of 'Compounding of Offences' under section 13 (1) of FEMA, 1999.

### **Maintenance of Records and Registers in E-Form made optional**

The Ministry of Corporate Affairs issued Companies (Management

and Administration) Second Amendment Rules, 2014 on 24.07.2014, making it optional for companies to maintain the registers and records in electronic form by substituting the word “shall” with “may” in Rule 27 sub rule 1 and the explanation to the rule.