Navigating retrenchments in India

Frequently Asked Questions under the Labour Codes

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ahead of the curve

This FAQ is intended to provide a general overview of the key legal and practical considerations relating to retrenchment in India considering the recent implementation of the Labour Codes, particularly the Industrial Relations Code, 2020 (**IR Code**). It addresses common questions on employee classification, retrenchment conditions, government filings, protected employees, mutual separation options, and implementation planning.

? Why is employee classification important for retrenchment planning?

Employees in India are broadly classified as: (i) "workers" under the IR Code; and (ii) other employees, generically referred to as non-worker employees. This distinction assumes significance since "workers" are entitled to specific statutory protections in relation to retrenchment, including notice, compensation, contribution to re-skilling fund, procedural safeguards and, in certain cases, government approval requirements. Careful classification helps ensure that the applicable legal framework is correctly identified and that employment decisions are implemented consistently and fairly.

? Can white-collar employees earning above INR 18,000 per month qualify as "workers" under the IR Code?

Yes, white-collar employees earning more than INR 18,000 per month may still qualify as "workers" under the IR Code, depending on their actual duties and responsibilities.

The definition of a "worker" under the IR Code is broad and covers employees engaged in technical, skilled, operational, or clerical work, among others. Whether an employee qualifies as a worker must be assessed based on their actual job profile, duties, and responsibilities rather than their designation alone. Employees who predominantly perform technical, skilled, operational, or similar work may qualify as a worker irrespective of their salary level.

The salary threshold of INR 18,000 is relevant only in respect of employees in supervisory roles. For employees performing other categories of work, salary is not a determining factor. White-collar employees performing mainly managerial or supervisory functions may fall outside the scope of the "worker" definition.

? Are the retrenchment conditions under the IR Code applicable only in case of redundancy / workforce optimisation /role rationalisation?

No, retrenchment conditions under the IR Code may apply to other types of employer-initiated terminations as well. "Retrenchment" is defined in a broad manner under the IR Code to mean termination by the employer of services of a worker for any reason whatsoever, other than a misconduct termination. The definition also excludes certain specific termination scenarios such as voluntary retirement, retirement on attaining the age of superannuation, non-renewal or expiry of fixed term employment, termination on account of ill-health, among others. Broadly speaking, employer-initiated termination simpliciter / termination without cause, is likely to be considered as "retrenchment".

Which labour code provisions govern retrenchment of workers?

Retrenchment of workers is primarily governed by Chapter IX of the IR Code, which deals with lay-off, retrenchment and closure. Chapter X of the IR Code contains special provisions for lay-off, retrenchment and closure in certain specified establishments.

In broad terms, Chapter IX applies to industrial establishments (including commercial establishments) that are not covered by Chapter X.

Chapter X applies to factories, mines and plantations employing 300 or more workers on an average per working day in the preceding 12 months, or such higher number as may be notified by the appropriate Government.

What are the key conditions for retrenchment under the IR Code?

The key conditions for retrenchment of eligible worker include:

i. providing the prescribed written notice or wages in lieu of notice to the worker, specifying the reasons for retrenchment;

ii. paying a retrenchment compensation calculated with reference to the concerned worker's tenure; and

iii. providing a notice of retrenchment to the prescribed government authorities, as applicable. Prior approval from the government is required for retrenchment if the establishment falls under Chapter X of the IR Code.

Additionally, the IR Code has introduced a new obligation in case of retrenchment of workers. Employers are required to contribute an amount equal to 15 days' last drawn wages of the retrenched worker to a worker re-skilling fund established by the appropriate Government. The Central Government has notified constitution of the re-skilling fund for establishments for which it is the appropriate Government. Most State Governments are yet to notify the worker re-skilling fund.

Any more favourable entitlements available to an employee under their employment contract or any other applicable law, including the relevant State shops and establishments legislation, will continue to apply.

Are employers required to follow retrenchment conditions under the IR Code in case of termination of employment on account of poor performance?

Indian courts generally treat poor performance termination as ***termination simpliciter*** and accordingly, such terminations may fall within the ambit of "retrenchment". Accordingly, in respect of worker category employees, retrenchment conditions would apply in case of termination on account of poor performance.

In case of non-worker employees, termination must be carried out in accordance with the local shops act (if applicable) and the employment contract/ policies.

In addition, judicial precedents have often emphasised the importance of fairness in performance-related terminations, including clear communication of performance concerns, reasonable opportunities to improve performance, appropriate support measures where relevant and adequate documentation.

When is prior government permission required?

Prior permission from the appropriate Government is required for retrenchment in industrial establishments covered by Chapter X of the IR Code, namely, factories, mines and plantations meeting the applicable worker threshold (which is 300 workers presently).

Establishments not covered under Chapter X may still have to provide intimation regarding the retrenchment to the appropriate Government in the prescribed manner.

What is the "last-in-first-out" principle?

The last-in-first-out principle means that, when retrenching workers in a particular category, the employer should ordinarily retrench the most junior worker in that category first. Employers are required to maintain a seniority list for this purpose. Any deviation from the "last-in first out" principle must be supported by a genuine documented reason.

Are there re-employment obligations after retrenchment?

Yes. The IR Code contains re-employment obligations in relation to retrenched workers. Employers proposing to hire for future vacancies should evaluate whether retrenched workers need to be given an opportunity for re-employment in accordance with applicable legal requirements.

What is the process for terminating employment of non-worker employees?

Termination of non-worker employees is generally governed by the applicable state shops and establishments legislation, the employment contract, company policies and principles of fairness. Majority of state-specific shops acts require employers to provide the prescribed notice period or wages in lieu (unless the termination is for misconduct). Certain state laws require employers to have a valid reason for termination and, in some cases, also provide severance compensation.

Are there some employees protected from termination?

Yes. Certain employees may have additional statutory protections that restrict or prohibit termination during specific circumstances, for example, employees availing maternity benefits, or if they qualify as "protected worker" under the IR Code. Where applicable, any such statutory protections and related restrictions should be taken into account when planning workforce reduction or restructuring measures.

What alternatives are available to a unilateral termination?

Mutual separation arrangements are often used as an alternative to unilateral termination. In a mutual separation, the employer and employee mutually agree on the terms of separation. At a minimum all statutory and contractual terminal payments would be payable in a mutual separation scenario. The separation terms, including any separation payments and employee transition support measures, and associated costs, will depend on the specific circumstances and the parties' discussions.

Voluntary retirement schemes (VRS) are another option that employers may consider as an alternative to unilateral termination. Under a VRS, employees voluntarily separate from employment in exchange for specified benefits, typically including an ex gratia payment.

These alternative separation options can facilitate workforce rationalisation while potentially reducing the risk of disputes and employee relations challenges that may arise from unilateral terminations. Given the legal and practical considerations involved, these arrangements should be appropriately documented.

What should employers document before implementing retrenchment?

Employers should document the business rationale for workforce reduction, the affected business units or roles, selection criteria, employee classification analysis, seniority lists where applicable, overall separation costs taking into account statutory and contractual terminal payouts, approvals, communications, and the implementation timeline.

What terminal payments should be considered in case of a retrenchment / termination simpliciter?

The key payouts include:

i. accrued unpaid salary;

ii. notice period or payment in lieu of unserved notice;

iii. statutory payouts such as retrenchment compensation, gratuity, statutory bonus, as applicable;

iv. contractual or customary payouts as may be applicable to the employee as per the terms of their employment contract or separation terms, which will be payable in accordance with applicable law and contracts / practices.

Additionally, applicable labour laws may prescribe specific timelines for settlement of various terminal dues. For example, "wages" (as per the Code on Wages, 2020) are generally required to be settled within 2 days of termination, gratuity within 30 days, and statutory bonus within 8 months of the close of the relevant accounting year. Applicable payment timelines should therefore be considered when processing separation-related payments.

Are there any consultation obligations in case of retrenchment?

While the IR Code does not expressly provide for consultation requirements, consultation obligations may arise under applicable collective bargaining agreements, settlement agreements, standing orders, or employment contracts, particularly where the workforce is unionised.

What operational issues should be planned for in case of retrenchment?

Before implementation, employers should evaluate business continuity, customer commitments, knowledge transfer, IT and system access, payroll processing, return of company property, data protection, immigration or work authorisation issues, and manager readiness.

What are the risks of non-compliance with retrenchment requirements?

Non-compliance with retrenchment conditions, procedural requirements, payment timelines or government approval requirements can expose employers to legal challenges, invalidation of termination, reinstatement claims, back wages, compensation, penalties and reputational risk.

What is the key takeaway for employers?

Workforce reduction should be planned early, documented carefully and implemented responsibly. Employers should assess whether the affected employees including white-collar employees would qualify as "workers", identify governmental intimation or approval requirements, and calculate and budget for separation payments, including re-skilling fund contributions, where applicable. While compliance with applicable legal requirements is the baseline, employers should also ensure transparent communication, fair and consistent decision-making, and respectful treatment of affected employees throughout the process. Early planning and appropriate documentation can help reduce disputes and support a smoother transition for all stakeholders.

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