



news flash

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SOFTWARE DEVELOPERS ARE “FACTORIES” UNDER ESI ACT

Bombay HC Ruling:

The Hon'ble Bombay High Court on 11 July 2012 in the appeal filed against Western Outdoor Interactive Pvt. Ltd., held that the Employees' State Insurance Act, 1948 (**ESI Act**) applies to software development companies. The findings of the Hon'ble Court are as follows:

Issues	Findings
(i) Whether creation of software or development of software itself is a manufacturing process or not?	Yes
(ii) Whether the premises where computers are involved in manufacturing process are a factory under the E.S.I. Act?	Yes

Madras HC Ruling Distinguished

The Hon'ble Bombay High Court disagreed with the view taken by the Division Bench of the Madras HC in the case of Seelan Raj & 14 Others v. P.O., I Addl. Labour Court & Ors {(1997) IILLJ 972 Mad} on the point of interpretation of “manufacturing process” in Explanation II of Section 2(m) of the Factories Act. The court observed that this issue is not finally decided and is still res-integra since the Hon'ble Supreme Court has referred the case to a larger bench.

Brief Facts of the present case

The Hon'ble Bombay High Court heard two appeals together, one filed by the ESI Corporation (**ESIC**) against Western Outdoor Interactive Pvt. Ltd. (**Western Outdoor**) and another filed by Reliable Software Systems Ltd. (**Reliable Software**) against ESIC. Both Western Outdoor and Reliable Software are engaged in the business of software development.

news flash

JULY 2012

The appeal by Western Outdoor was filed against an order passed by the Employees' State Insurance Court (**ESI Court**) which held that the activities carried out by Western Outdoor are not "manufacturing process" and hence it is not a "factory" under the ESI Act.

The second appeal was filed by Reliable Software challenging the order of the ESI Court which held that software development is a "manufacturing process" and hence Reliable Software is a "factory" under the ESI Act.

Both appeals involved the same question of law regarding the coverage of the software development companies under the ESI Act and were therefore heard and decided together.

Important Observations of the Court

ESI is a progressive legislation

- The ESI Act is a welfare legislation and the application of ESI Act is not a regressive but a progressive step. To think that if ESI Act is made applicable then it will affect IT industry adversely is a futile fear.

ESI Circular dated 22 November 2002

- Reference was made to the circular dated 22 November 2002 issued by the ESIC where it was decided to treat certain establishments engaged in IT enabled services and other commercial activities as "shops" for the purpose of coverage under section 1(5) of the ESI Act. This circular and the scope of "factory" in section 2(12) of the ESI Act read with the meaning of "manufacturing process" under Explanation II of Section 2(m) of the Factories Act look interlinked and alike, but they are separate issues and are not to be mixed up.
- The ESI Court, while allowing the claim of Western Outdoor, has erroneously relied on the circular dated 22 November 2002. The ESI Court ought not to have given undue weightage to that circular.
- The circular was issued with an object to enhance the meaning of word "shop" and it was not with a view to restrict the meaning of manufacturing process which is one of the ingredients of the "factory" under the ESI Act.

Definitions of "factory" and "manufacturing process" under the ESI Act & the Factories Act

- The definition of "factory" in the Factories Act and the ESI Act are not the same. Explanation II of Section 2(m) of the Factories Act is inserted in the Factories Act and not in the ESI Act. It marks the difference in its interpretation and application.
- In the definition of "factory" under Factories Act the words "worker working" are used, while in the ESI Act, in the section defining "factory", the term "person employed for wages" are used. A difference in these two definitions of one word "factory" can be explained by example. A clerk or staff in the premises is not covered under the definition of "worker" under the Factories Act, however, under the ESI Act, the word "worker" is not used but the legislature chose the word "person" and for "working", the

JULY 2012

word “employed” is used. Thus, the premises where person is employed for a clerical work is covered under the definition “factory” under the ESI Act. Therefore, definition of “factory” has wider meaning under the ESI Act than the Factories Act.

- Reliance was placed on the decision in the case of Quzi Noorul, H.H.H. Petrol Pump and Anr. Vs. Deputy Director, Employees’ State Insurance Corporation, reported in {(2009) 15 SCC 30} wherein it was held that the words “manufacturing process” in different statutes have different meanings and we cannot apply the definition of “manufacturing process” in one statute to another statute”.
- The section defining the term “manufacturing process” allows for wide interpretation. Though computer related activities like development, programming and application are not mentioned in the definition and to that effect there is no amendment in the section; the definition takes care of activities like development and application.
- Reliance was placed on the clarification provided in a letter¹ dated 9 December 2003 issued by the Joint Director, ESIC, New Delhi to the Regional Director where it was communicated that the letters dated 9 March 2003 and 22 September 2003 issued by Directorate General, Government of India, Ministry of Labour and Factories, Advisory Services and Labour Institutes, clarified that the term ‘software development’ falls within the meaning of ‘manufacturing process’ under section 2(k) the Factories Act. Adopting this clarification, the court held that software development is a manufacturing process.
- The present appeals being under the ESI Act, the interpretation of “manufacturing process” and the term “factory” were to be understood for the purpose of ESI Act and not under the Factories Act.

Implication

The judgment being delivered by the Hon'ble Bombay High Court is binding on judicial / quasi judicial authorities in the state of Maharashtra and will have a persuasive value in the courts of any other jurisdictions.

It remains to be seen whether any appeal will be filed against the order of the Bombay High Court. Until then, software development companies fall within the ambit of the ESI Act as far as Maharashtra is concerned.

With respect to applicability of Factories Act to software developers, it is yet to be decided by the larger bench of the Supreme Court in the case of Seelan Raj.

¹ The letters appear to be internal communications between the labour authorities and are not publically available.

news flash

JULY 2012

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