Corporate Restructuring: Who Cares for the Employees?

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In the era of globalization the need to strike a balance between employee security and business requirements has become crucial. Mergers and acquisition laws allow the companies to restructure for various reasons. The Companies Act duly recognizes and protects the interests of the creditors and shareholders, whereas the employees have no say during the merger and they are forced to accept the terms prescribed by the employer during the transfer of an undertaking. This paper examines the extent to which the existing legal regime protects the interest of the employees during the transfer of an undertaking. The paper also gives some suggestions for improving and protecting the labor force during corporate restructuring.

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Introduction

"A corporation represents far more than its current stock price; it embodies obligation to employees, customers, suppliers and communities" (Samuel, 1985)

Mergers and amalgamations are seen as one of the modes of corporate restructuring. But it has some adverse impacts on the employees as it results in layoffs, retrenchments due to closing down of some of the industrial units of the company. Along with this is the problem of new work culture, adjustability to the new environment of work etc. Managers of mergers attempt, as do other managers, to organize and direct their enterprises in such a manner that, all things considered, the least unit cost of operation is attained (Stone, 1930). The larger a firm is in relation to the size of the community in which it operates, the greater disruption any such change is likely to have (Macey, 1989). A scheme of merger/amalgamation or takeover is a statutory right of the companies. Provisions of the Companies Act, 1956 in India take care of the interest of the class of creditors and shareholders and they may have to approve the scheme.

This paper examines the extent to which the existing legal regime protects the interest of the employees during transfer of an undertaking. First part of the paper studies merger laws in India and their impacts on the labor under the provisions of the Companies Act and the Banking Regulation Act, 1949. The second part of the paper studies the constitutional law protection afforded to the companies to restructure and thereby achieving an economic equilibrium. The third part studies the role of Indian labor legislations in protecting the interest of the employees during transfer of an undertaking with the help of the decided cases. The papers also analyses the guidelines issued by other countries and labor organizations in this regard. Finally the paper gives some suggestions for improving and protecting the labor force during corporate restructuring.

Basis of Industrial Jurisprudence

The preamble to the Constitution of India states that it is a socialistic state. The basis of socialist state is embodied under the Directive Principles of state policy commonly known as Part IV of the Constitution of India. Directive Principles are essentially not enforceable before any court of law. But they are fundamental in the governance of the country and must be applied by the state while making laws as per Article 37. Within this part Art. 39(b) and Art.39 (c) requires the state to ensure fair distribution of wealth and prevention of concentration of wealth in the hands of few. Art. 41 requires it to secure right to work for its people within its economic capacity. Just and human conditions of work and living wages for works also essential for the proper enjoyment of right to work. Finally, Art.43- A requires it to take steps to ensure the participation of workers in the management of industries. These articles form the substratum of the Industrial Jurisprudence in India (Malhotra, 2004).

Merger Laws & Labor Force

In India, company mergers are governed by the Companies Act, 1956 and bank mergers are governed by the Banking (Regulation) Act, 1949. S. 293 (1) (a) of the Companies Act confers powers on the board to sale, lease or otherwise disposal of the whole or substantially whole of the undertaking. The procedure of transfer would be considered as fair under s. 293 if the consent of the members of the company is obtained. It is to be noted here that the other stakeholder interests have not been protected during transfer of an undertaking. S. 391 of Companies Act, 1956 give the court the power to sanction a merger or reconstruction between the company and its members and company and its creditors. The court enjoys more power under this section because it not only sanctions a merger or reconstruction but also looks into the substantial compliance of statutory provision and also look into whether the scheme is *bonafide* exercise of majority power and that the scheme is reasonable. The courts also have the power of calling meeting of class of creditors and members and in many cases it looked into the interest of the employees. In the case of *Krishnakumar Mills*

Ltd (1975) the scheme brought before the court required that the workers waive their claims to compensation under the Industrial Disputes Act, 1947 and also forego their claims to notice money and gratuity. The court found the proposal unfair and refused to allow a meeting of creditors to be called to consider the scheme. J. Padmanabhan, in a landmark case stated that the court is not a rubber stamp in sanctioning a scheme unders. 391-394. Another pertinent section is Section 394 of the Companies Act, 1956. It provides the Court with specific powers with respect to mergers and amalgamations. In particular both the provisos to Section 394 (1) subject to the sanction of the court to the criterion that 'the affairs of the company have not been carried on in a manner prejudicial to the interest of its members or public interest'. The courts have used this provision to protect the interest of the employees which has often been co-opted into public interest.

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Restructuring of companies in trauma is provided under PartVIA of the Companies Act. It provides an opportunity to the sick industrial companies to rehabilitate and restructure according to the procedure under Part VI A. A similar provision is contained in Part IV of the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 for the financially weak companies.

Further under Ss. 494 and 507 of the Companies Act, 1956, an alternative route to voluntary winding up is provided for protecting the interest of shareholders and creditors. It provides for merger through voluntary winding up by the members and creditors.

The Companies Act provisions dealing with corporate restructuring do not protect the employees interest. This is in contrast with the right of the members and creditors whose express consent is required for such a scheme. This means that it is the court that has to step in to pro-actively protect the interest of the workers. Therefore, it is to be noted here that the merger provisions under the Companies Act is not in consonance with the emerging stakeholder –based model of corporate governance.

Locus Standi of the Employee

One of the main issues the court had to resolve so as to protect the interest of the workers was the issue of *locus standi* of the employees to object to the scheme and the extent to which their obligations must be considered. The issue of *locus standi* of the employees in merger had come up before the Bombay High Court in *Hindustan Lever Employees Union v. Hindustan Liver Ltd and others (1995).* It was found that even though the Companies (Court) Rules do not provide for giving notice to the employees for meeting to approve the schemes, in contrast with the provisions made for creditors and members, there is a provision for public notice of hearing of sanction by the court and the employees can

put forward their concern at this point. The court also noted that the 'worker is certainly a valuable part of the business and not an insignificant partner along with the capital management and hence the court must take into consideration his concerns while according sanctions under S. 391 or 394. The Judgment of Justice V.A. Mohata, in this case was upheld by the Supreme Court in an appeal by Justice R.M. Sahai. Another case pertaining to the same issue decided by the Bombay High Court was in the case of *K EC International Ltd v. Kamani Employees Union (2002).* In this case the trade union of the amalgamating company filed a suit opposing the petition for sanctioning a scheme of amalgamation filed by the amalgamating company. Their contention was that the statutory requirements under Section 391- 394 and the requirements as per the Companies (Court) Rules had not been complied with. Some of the employees were shareholders in the company as well and the union stated that it was appearing in a representative capacity on their own behalf. The company objected on the ground that the union could not represent the employees as shareholders. If the shareholders wished to sue they could sue on their own behalf.

But a different stand was taken by the Karnataka High Court in *Harihar Poly fibers v. Karnataka Forest Development Employees Union (2003)* In this case a government owned corporation was to takeover another company by acquiring 49% of its shares. The employee Union of the Government Corporation objected to the scheme by means of a writ petition. It was held that the union's rights were not affected by the proposed amalgamation; it had no *Locus Standi* object to the scheme. Dismissing this contention, J.S. Radhakrishnan found that the employees have a right to object with regard to a merger as the employees are the backbone of the petitioner company and their interest ought to be protected.

Employees have a right to object with regard to a merger.

Another case wherein the issue of the interest of the employees involved was that of *John Wyeth (India) Ltd v. Geoffrey Manners and Company Ltd (1988)* in which case the respondent company had to be merged with the petitioner company. Under the scheme, all the workers of the amalgamating company were to be compulsorily transferred to Wyeth, the amalgamated company along with the machinery assets and liabilities. Their contention was that since Wyeth was a loss making company while Manners had been making profits, the transfer would adversely affect them and hence they did not wish to be transferred. At the outset, the Bombay High Court speaking through J. Sujata Manohar agreed with the workers' contention and found that they could not be forcibly transferred. It was held that those who wished to be transferred could do so and would be protected under the merger scheme. Those who did not wish to be transferred could remain with Manners and would be entitled to all such rights and remedies as they may be entitled to in law.

Employment Protection

Section 45 of the Banking Regulation Act, 1949 empowers the Reserve Bank of India to apply to the Central Government for suspension of banking business and to prepare a scheme of amalgamation. Section 45(5)(i) of the Banking Regulation Act , 1949 provides that the employees of the transferor company should be provided with similar remuneration and terms and conditions of employment as that of the employees of the transferee company. Provided that the employee is not a workman within the meaning of S. 2(5) of the Industrial Disputes Act, 1947**.** This section further provides that the employees of the transferor company should be given the same rank and status in the transferee company. The only right of such employees whose service is so continued is to claim parity with the employees of the transferee bank itself of a corresponding rank or status subject to equivalent qualification and experience and no more. The transferred bank employee cannot get better conditions of service than the corresponding employee of the transferee bank (M.S.Jasara v.Governor, RBI (1992). Under no circumstances can the remuneration of a transferred employee be adversely affected on the amalgamation of two banks (Chairman, Canara Bank Bangalore v. M.S. Jasara(1992). This view was upheld by the supreme Court in *State Bank of Travancore v. Elias Elias (1971)*. Also in *State Bank of Travancore v. General Secretary, Association of the state bank employees and others (1978)* it was held that in the assessment of the experiences of the employees of the transferor bank as compared with the experience of the employees of the transferee bank, the account has to be taken not merely of the length of the service but also the factors such as the standard of efficiency in the transferor bank, the variety, the quality, the volume of business transferred by it etc. In *New Bank of India Employees Union v. Union of India (1996),* it was held that when a scheme is framed under Section 45 for amalgamation, judicial review is permissible to a very narrow extent. Particularly when a dispute or difference arising with regard to the equivalence of experience has been decided by the Reserve Bank of India, in exercise of its powers under the second proviso to Section 45 (5) (i), the High Court in the writ jurisdiction cannot sit in appeal over such judgment. It can only interfere in extreme cases of arbitrariness or unreasonableness. As to the criteria adopted for judging the equivalence of experience in two different banks which are being amalgamated Reserve Bank of India being an expert body in banking operations would be the best judge. It was further reiterated in *State Bank of Travancore v. Its Association (1978)* wherein Division Bench of the Kerala High court stated that 'experi-

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ence may generally mean the length or duration of service in a profession or institution, but the court cannot altogether rule out the richness and nature of the experience in the matter of service in a bank. The quality of service, efficiency of organization and the range and volume of business transacted must all contribute to the experience gained in a bank.

S. 45 (5) is basically a mandate to the Reserve Bank of India that the scheme framed by it must contain all the provisions mentioned in the sub-section of the concerned scheme. The sub-section further casts an obligation that the scheme must provide for the continuance of the service of all those employees who are workmen within the meaning of the Act of 1947. In *Piara Lal Anand v. State Bank of India(1972)* case it was laid down that Sub-section (5) of Section 45 of the Act is only an enabling provision and gives discretion to the Reserve Bank to provide for all or any of the matters it deems fit, but it was not mandatory that the scheme must contain all the matters mentioned in Section 45 (5) of the Banking Regulation Act. In *K.L. Shepherd v. Union of India (1989)* court was dealing with the scheme of amalgamation under Section 45 of the Banking Regulation Act with regard to the status of the employees of the amalgamated bank who were excluded from the service of the transferee bank while retaining other similarly situated employees. In this context the court came to the conclusion that the scheme should uphold the principles of natural justice.Section 45 (5) (i) was primarily incorporated in the Banking Regulation Act, 1949 so as to give a statutory assurance to the position of employees in merger (Indian Bank v.K. Usha, 1988) .

Position of Employees

EU merger regulations entitle not only the concerned companies, competitors and the interested parties, but also the recognized employees of the representatives of the concerned companies, upon the application to be heard by the commission during its merger procedure. This is particularly of importance to the employee representatives, since company mergers and takeovers frequently entail major company restructuring and reduction of the combined work force.The merger control procedure can provide the unions and the European work council with useful information in terms of anticipating restructuring and ensuring that management informs and consults with the employee representatives in good time on any merger or acquisition plans.

In United Kingdom the Transfer of Undertakings (Protection of Employment) Regulations, 2006 (TUPE) protects employees terms and conditions of the employment when a business is transferred from one owner to another. The employees continuity of service and any other rights are preserved and the companies have a duty to inform the employees.

In *India* S. 25 FF of the Industrial Disputes Act, 1947 was introduced in 1957 to clarify the rights of the workers subsequent to transfer of an undertaking. The only right that the enactment of

S.25FF has given to workers is the right to claim compensation. According to this section, when the ownership and management of a company is transferred from the original employer to a new one, by virtue of an agreement (such as a merger scheme) or by operation of law (under s. 396 of the companies Act), every worker who has been in service with the original employer for a period of more than one year and whose service has been interrupted by transfer is entitled to one month's notice in writing indicating the reason for change and compensation equal to 15 days average pay for every completed year of service from the original employer. In *Workmen of Karnataka Agro Proteins Ltd v. Karnataka Agro proteins Ltd and others (1992),* the court held that in all cases to which S. 25FF applies, the only claim which the employees of the transferred concern can legitimately make is a claim for compensation against their employers. No claim can be made against the transferee of the said concern.

Conclusions & Suggestions

In the era of globalization the need to strike a balance between employee security and business requirements has become crucial. First defect is in the structure of the Company Law in India which fails to consider the workers as an important constituency whose consent must be obtained when a scheme of amalgamation is proposed. While the creditors and members are allowed to have a say in the process due to specific provisions of the Companies Act, the workers' interests are simply merged with the general category of 'public interest'.

Therefore firstly, The Companies Act should include specific provisions whereby employees' right must also be recognized. Secondly, employees should have the right to information and consultation, when a company proposes to merge with another company. Thirdly, there must be clear distribution of liability between the old and the new employers. Fourthly, right of the trade unions to object the merger should be recognized. Finally, the employees should be given the individual right to object the merger scheme.

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