When Push Comes to Shove: Contracting and Labor-Only Contracting in a Globalized Setting

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WHEN PUSH COMES TO SHOVE: CONTRACTING AND LABOR-ONLY CONTRACTING IN A GLOBALIZED SETTING*

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I. INTRODUCTION

Labor-only contracting has now become one of the most pervasive patterns of employment. Replacing the traditional employer-employee relationship, this form of employment contemplates a triangular employment relationship,[1] where labor-leasing agencies reject the status of mere labor intermediaries and assume the status of ongoing "employers" of workers assigned to client business enterprises. Workers' toil for the client enterprises translate into hourly profits for the labor-only contractor.

This practice - called *marchandage*[2] in France, *cesión de trabajadores*[3] in Spain, and *"temporary work"*[4] in the United States - has been declared unlawful in several jurisdictions due to the numerous abuses committed by

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[1] "In this arrangement, the labor leasing agencies, although "assigning" workers to their clients (or user firms), simultaneously place these workers for legal purposes on their own payroll, billing client firms in an amount covering wages, overhead, and profit. They thus claim the status of "employer" of these workers and assume, ostensibly at least, responsibility for formal compliance with the key legal requirements connected with this role - even as a third party, the client firm, utilizes the labor power provided." George Gonos, *The Contest Over "Employer" Status In The Postwar United States: The Case Of Temporary Help Firms*, 31 L. & SOC'Y REV. 81, 85 (1997).

[2] Christophe Vigneau, *Temporary Agency Work in France*, 23 COMP. LAB. & POL'Y J. 45, 46 (2001).

[3] Miguel Royo, *Temporary Work and Employment Agencies in Spain*, 23 COMP. LAB. & POL'Y J. 129, 149 (2002).

[4] Gonos, *supra* note 1, at 81.

leasing agencies or labor intermediaries such as misrepresentation of wages, extortionate fees, kickbacks to foremen, inducement of discharges to increase business, white slavery and blacklisting of union members.[5]

Philippine law does not directly prohibit the practice. However, it grants the Secretary of Labor and Employment the discretion to regulate or prohibit it.[6] To date, the Secretary of Labor has already issued several regulations prohibiting the practice. This notwithstanding, labor-only contracting persists in all sectors of the economy.

It has been observed that labor-only contracting has become the most prevalent employment practice eroding worker's rights to security of tenure, humane employment terms and conditions, self-organization and collective bargaining. Moreover, the law governing labor-only contracting has been used as a legal device to justify non-regularization of workers and to evade payment of higher wages and other employment benefits.

An outraged Supreme Court confirmed these observations when it vocally condemned the practice and called to the other branches of government to stop it:

> The scourge of exploitation of labor, as shown by numerous petitions before us, remains pervasive. It is imperative for all government agencies concerned to exert all-out efforts to prevent any further violation or circumvention of the provisions of the Labor Code through deceptive devices and malpractices. Unscrupulous employers could not be allowed to hide behind labor-only contracting in order to escape the just claims of their workers and other employees.[7]

In answer to this call, the writers reviewed all the executive and judicial actions on labor-only contracting from 1974 to 2003, and humbly propose to provide legislative and executive seals for legal loopholes that employers have brazenly used to exploit workers. This article seeks to end the practice of labor-only contracting by proposing to prohibit it outright, clearly delineating it from permissible job contracting, supplying conditions and indications that establish its existence, and highlighting effects that

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[5] Matthew Finkin & Sanford Jacoby, *An Introduction To The Regulation Of Leasing And Employment Agencies*, 23 COMP. LAB. L. & POL'Y J. 1, 2 (2001), *citing* IRVING BERNSTEIN, A HISTORY OF THE AMERICAN WORKER 1920-1933: THE LEAN YEARS 239 (1960).

[6] LAB. CODE, art. 106.

[7] Jang Lim v. Nat'l Lab. Rel. Comm'n, G.R. No. 124630, 303 SCRA 432, 447, Feb. 19, 1999.

would serve as sanctions. These delineations, conditions, and sanctions, as supplied by regulations and jurisprudence, served as the bases of the writers' proposals.

For a deeper understanding of the practice, this article first traces the history of labor-only contracting to its roots, and the subsequent transformations and underlying factors that led to its present prevalence in the labor market. A list of the specific permissible or impermissible areas of job contracting, as determined by the Supreme Court, is also provided to serve as a guide to contractors and employers.

A. HISTORICAL BACKGROUND

1. The "sweating system" in the United States

Labor contracting is no novel occurrence in the United States. Until about seventy years ago, the use of labor intermediaries was commonly known as "the sweating system," and its victims worked in "sweating shops." The "sweated trades" included production of a wide variety of garments, as well as cigars, artificial flowers, dolls, brushes, and purses. During the late 1800s and early 1900s, the "sweating system" was prevalent, disguised as labor subcontracting, temporary agencies, employee leasing, misclassifying employees as "independent contractors," outsourcing, and other methods of "sweating a profit" out of workers through labor intermediaries.[8] In 1893, the Illinois Bureau of Labor Statistics wrote:

> In practice, sweating consists of the farming out of the competing manufacturers to competing contractors the material for garments, which, in turn, is distributed among competing men and women to be made up. The middleman, or contractor, is the sweater and his employees are the sweated or oppressed. He contracts to make up certain garments, at a given price per piece and then hires other people to do the work at a less price. His profit lies in the difference between the two prices.[9]

Over a century ago, an author wrote:

> In the days of Queen Anne the name sweater was given to a class of ruffians who went about the streets and formed a circle about any hapless way farer whom they met, and by pricking him with their swords compelled him to dance until he sweated from the exertion.

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[8] Bruce Goldstein et al., *Enforcing Fair Labor Standards in the Modern American Sweatshop*, 46 UCLA L. REV. 983, 1055 (1999).

[9] *Id.* at 1058, *citing* ILLINOIS BUREAU OF LABOR STATISTICS 358 (1893).

> The sweater is not now looked upon as a ruffian, but he gathers his victims by the score in city shambles and goads them to work until their life blood fairly oozes out of their pores.[10]

2. The Philippines: From "cabo system" to manpower agencies

Atty. Rodrigo Kapunan[11] traced the history of labor contracting to the *"cabo"* system,[12] which originated from the Chinese *"coolie"* system.[13]

During the Spanish regime, the *cabo* system was accepted as a form of legitimate business due to the absence of laws on labor relations. The system was commonly practiced in *haciendas* which hired seasonal plantation workers, in logging companies, in maritime companies with respect to stevedores, and in small construction firms. The *cabos* took it upon themselves to pay workers' wages on a per-piece basis, impose discipline, select which workers would receive jobs, and dictate the amount to be paid.[14]

During the American regime, the introduction of trade unionism by the American authorities led to the decline of the *cabo* system. As American authorities grew stricter and required employers to pay wages directly to workers instead of to labor suppliers, *cabos* had to move out and transfer to areas where the need for labor was irregular or where the employers changed frequently but demand for labor remained continuous, such as in arrastre

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[10] Frank Goodchild, *The Sweating System in Philadelphia*, ARENA, Jan. 1895, at 261–62, *cited in* Goldstein, *supra* note 8, at 321.

[11] Rodrigo Kapunan, *Labor-only Contractors: New Generation of "Cabos"*, 65 PHIL. L.J. 5 (1991).

[12] A person acting as a labor negotiator and supplier. The Supreme Court defined the term as "an arrangement between a shipping company and a labor organization, for arrastre and stevedoring services, whereby the latter (as an independent contractor) engages the services of its members as laborers who are paid on union payrolls, and the charges for such services are made directly by the union against the consignees and owners of the cargoes, all without the intervention of the shipping company." Allied Free Workers Union v. Compania Maritima, G.R. No. 22951, 19 SCRA 276, 277, Jan. 31, 1967.

[13] The term refers to laborers whose contract specified conditions approximating servitude, slavery or peonage. The Brown Quarterly, *The History of Chinese Immigration*, *at* http://brownvboard.org/brwnqurt/03-4/03-4c.htm (2000). "Coolie" comes from the Chinese term *ku li* which means "bonded labor." Hoover Library, *1900: The Boxer Rebellion*, ¶ 11, *at* http://hoover.archives.gov/exhibits/China/Political Evolution/1900 (last visited Dec. 20, 2004).

[14] Kapunan, *supra* note 11, at 6.

and stevedoring services. Later, *cabos* formed or infiltrated labor unions and used them as instruments to supply labor to employers.[15]

The practice of labor-only contracting emerged with the decline of the *cabo* system. Clothed with legitimacy and purporting to be working for members' rights, labor unions openly engaged in supplying labor. Other innovative labor suppliers formed new outfits and called themselves service or manpower placement agencies, clerical and office specialists, entertainment promoters, job recruitment offices, employment consultancies, or even independent job contractors.[16] Labor-only contracting picked up momentum during the Marcos dictatorship from the 1970s to mid-1980s. During this period, Presidential Decree No. 442 or the current Labor Code was promulgated, and it allowed companies to hire workers on contract for special works.[17] In the 1980s, manpower agencies became popular among big establishments due to the ever-deepening economic crisis and the dominance of militant trade unions in the labor movement.[18] The 1997-98 financial crises further accelerated labor-only contracting due to growing unemployment and sharpened divisions within the working class. To date, labor-only contracting is pervasive in all industrial establishments.

3. The ILO experience: From prohibition to legitimization

The International Labor Organization ("ILO") formerly opposed private labor market intermediaries,[19] believing these undermined the principle that "labour is not a commodity."[20] It called for the abolition of profit-driven employment agencies upon its founding in 1919. In 1933, it expressly prohibited employment services "which charge fees or which carry

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[15] *Id.*

[16] *Id.*

[17] Bulatlat.com, *The Mall Empire That Slavery Built*, BULATLAT, Jul. 13-19, 2003, ¶ 14, *at* http://www.bulatlat.com/news/3-23/3-23-mallempire.html.

[18] Rene Ofreneo, *The Economic and Legal Dimensions of Labor-Only Contracting*, ISSUES & LETTERS, Jul. 1995, at 2.

[19] "Any person, company, institution, agency or any other organization which acts as an intermediary for the purpose of procuring employment for a worker or supplying a worker for an employer with a view to deriving either directly or indirectly any pecuniary or other material advantage from either the employer or the worker." ILO Convention No. 34, Fee-Charging Employment Agencies Convention, Jun. 29, 1933, *available at* http://www.ilo.org/ilolex/cgi-lex/convde.pl?C034.

[20] Frances Raday, *The Insider-Outsider Politics Of Labor-Only Contracting*, 20 COMP. LAB. L. AND POL'Y J., 413, 413 (1999).

out their business for profit" through ILO Convention No. 34.[21] In 1997, however, it reversed its historic stance when it promulgated Convention No. 181[22] which legitimized labor intermediaries not only as job placement agencies, but also as direct providers of labor services. The instrument abandoned the old scheme of prohibiting private employment agencies and instead regulated profit-making agencies, thus legitimizing them.[23]

B. THE CONFUSION OF LABOR-ONLY CONTRACTING

1. Factors affecting labor-only contracting

Labor scholars have identified globalization and evolving state policies as the two major factors that brought about the rise of labor-only contracting. Similarly, the ILO justified its policy shift from absolute prohibition in 1919 to legitimization in 1997 because of needs to: a) allow managerial flexibility as a direct result of globalization; and b) follow the practice of states in permitting and regulating the employment practice.[24]

The non-traditional modes of employment and all the forms of "flexible"[25] or contingent labor are a direct result of globalization.[26] The growth of contingent employment has been associated with the desire of employers to be more "flexible" in terms of both the number and types of

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[21] ILO Convention No. 96, Fee-Charging Employment Agencies Convention (revised), Jan. 7, 1949, art. 2(1), *available at* http://www.ilo.org/ilolex/cgi-lex/convde.pl?C096.

[22] ILO Convention No. 181, Private Employment Agencies Convention, Jun. 19, 1997, art. 2(3), *available at* http://www.ilo.org/ilolex/cgi-lex/convde.pl?C181.

[23] Raday, *supra* note 20, at 415.

[24] Leah Vosko, *Legitimizing the Triangular Employment Relationship: Emerging International Labour Standards from a Comparative Perspective*, 19 COMP. LAB. L. & POL'Y J. 43, 54, 64 (1997); Anne Trebilcock, *A Comment on "Legitimising the Triangular Employment Relationship"*, 19 COMP. LAB. L. & POL'Y J. 43, 81, 83 (1997).

[25] Labor flexibility means "flexibility in the deployment of human resources, in working practices and in wages," and "the ability to reduce or increase employment or wage levels with ease; the ability to increase mobility; the ability to make more elastic use of skills; the ability to introduce non-conventional working arrangements." Maragtas Amante, Diversity in Contingent Employment Practices in the Philippines: Policy Options. Study Group on Philippine Labor Law Reforms and the Future of Work Relations, at 4 (Mar. 18, 2000) (unpublished paper submitted for consideration by the Commission on Labor, on file with the Congress of the Philippines).

[26] Roger Blanpain, The World of Work and Industrial Relations in the 21st Century in Developed Market Economies in Reports to the International Conference on the Role of Private Employment Agencies in Modern Market Economies (Apr. 1998) (unpublished paper on file with the University of Leuven, Belgium and the author).

workers, in order to be more responsive to the needs of both domestic and export markets. Job contracting, casual, temporary, probationary and "project-based" employments are all forms of contingent employment.[27] One of the most pervasive forms of labor flexibility is labor-only contracting, the prevalence of which has grown in recent years despite its being formally illegal.[28]

In 1990, the Philippine Supreme Court took judicial notice of the general practices adopted by government and private institutions and industries to hire independent contractors to perform special services.[29] These include janitorial,[30] security guards[31] and even technical and other services such as those performed by radio or telex operators, machine operators, and messengers.[32] In the same year, the Court pronounced in *Brent School, Inc. v. Zamora*[33] and *Pakistan International Airline v. Ople*[34] that even if article 280 of the Labor Code recognized regular employment, the law does not preclude instances where a fixed period of employment was agreed upon knowingly and voluntarily by the parties, without any force, duress or improper pressure being brought to bear upon the employee and absent any other circumstances vitiating his consent, or where it satisfactorily appears that the employer and employee dealt with each other on more or less equal terms with no moral dominance whatever being exercised by the former over the latter."[35] This effectively eroded the security of tenure of regular workers.

The Department of Labor and Employment ("DOLE") took the cue by issuing regulations that institutionalized flexible working arrangements. In February 1992, it issued Dep't Order No. 5, or the Revised Rules

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[27] Amante, *supra* note 25.

[28] Christopher Erickson et al., *From Core to Periphery? Recent Developments in Employment Relations in the Philippines* 3, 42 INDUSTRIAL RELATIONS: A JOURNAL OF ECONOMY AND SOCIETY 369 (July 2003).

[29] Kimberly Independent Labor Union for Solidarity, Activism and Nationalism-Organized Labor Association (hereinafter "KILUSAN") v. Drilon. G.R. No. 77629, 185 SCRA 190, 205, May 9, 1990.

[30] Rhone-Pholenc Agrochemicals Phil., Inc. v. Nat'l Lab. Rel. Comm'n. G.R. No. 102633, 217 SCRA 249, Jan. 19, 1993.

[31] Shipside, Inc. v. Nat'l Lab. Rel. Comm'n, GR No. 50358, 118 SCRA 99, Nov. 2, 1982.

[32] Neri v. Nat'l Lab. Rel. Comm'n, G.R. No. 97008, 224 SCRA 717, Jul. 23, 1993.

[33] G.R. No. 48494, 181 SCRA 702, Feb. 5, 1990.

[34] G.R. No. 61594, 190 SCRA 90, Sep. 28, 1990.

[35] Pakistan International Airline v. Ople, 190 SCRA 90, 101, *citing* Brent School, Inc. v. Zamora, 181 SCRA 702, 716, Feb. 5, 1990.

Implementing Labor Code provisions on the employment of home workers. In 1994, it issued Department Order No. 40, which revised the guidelines for the computation of minimum wage and other wage-related benefits for workers of service contractors, such as security and janitorial service agencies. In March 1997, three years after GATT-WTO was ratified by the Philippine Senate, DOLE issued Dep't Order No. 10, which led to the further proliferation of labor-only contracting agencies by its listing of several areas of permissible contracting.

2. The ambivalence of the law on labor-only contracting

The law governing labor contracting arrangements is embodied in article 106 of the Labor Code:

> *Contractor or subcontractor.* – Whenever an employer enters into a contract with another person for the performance of the former's work, the employees of the contractor and of the latter's subcontractor, if any, shall be paid in accordance with the provisions of this Code.
>
> In the event that the contractor or subcontractor fails to pay the wages of his employees in accordance with this Code, the employer shall be jointly and severally liable with his contractor or subcontractor to such employees to the extent of the work performed under the contract, in the same manner and extent that he is liable to employees directly employed by him.
>
> The Secretary of Labor may, by appropriate regulations, restrict or prohibit the contracting out of labor to protect the rights of workers established under this Code. In so prohibiting or restricting, he may make appropriate distinctions between labor-only contracting and job contracting as well as differentiations within these types of contracting and determine who among the parties involved shall be considered the employer for purposes of this Code, to prevent any violation or circumvention of any provision of this Code.
>
> There is "labor-only" contracting where the person supplying workers to an employer does not have substantial capital or investment in the form of tools, equipment, machineries, work premises, among others, and the workers recruited and placed by such persons are performing activities which are directly related to the principal business of such employer. In such cases, the person or intermediary shall be considered merely as an agent of the employer who shall be responsible to the workers in the same manner and extent as if the latter were directly employed by him.

A perusal of this article leads to several observations. First, the Code recognizes that contracting out work is a legitimate business option. Second, it holds the beneficiary-employer solidarily liable with his contractor to the latter's employees should the latter fail to pay their wages. Third, the Code becomes ambivalent on the issue of "contracting out of labor" when it states that the Secretary of Labor "may restrict or prohibit" the practice. Fourth, it distinguishes between labor-only contracting and job contracting based on two criteria: a) the existence of capital or investment in the form of tools, equipment, machineries, work premises, among others; and b) the relation of the work performed by the contractor's employees to the principal business of the beneficiary-employer.[36]

Clearly, the Code does not prohibit labor-only contracting. Instead, it delegates the discretion to prohibit or restrict such contracting schemes to the Secretary of Labor, and empowers him to distinguish between labor-only contracting and job contracting. Lastly, the Code provides the standard to be followed: the protection of workers' rights.

Various labor scholars have severely criticized this provision. One leading criticism is that it fails to categorically delineate legitimate job-contracting from labor-only contracting. According Professor Cesar Azucena, Jr., the dividing line "is ill-defined, confusing and overlapping."[37] To prove his point, he referred to the numerous confusing rulings in jurisprudence where the labor arbiter, the National Labor Relations Commission, the Court of Appeals and the Supreme Court would disagree whether an arrangement is job contracting or labor-only contracting. Indeed, the provision's definition of labor-only contracting is vague. To further compound the problem, the provision failed to provide a definition of job contracting. Moreover, it failed to clearly distinguish between permissible and impermissible types or areas of labor contracting. Finally, the sanction for labor-only contracting, which is to make the principal employer and the labor-only contractor solidarily liable to the workers, is inconsistent with the rule in agency that a principal is solely liable for acts performed by the agent within the scope of his authority.

Since there are no hard and fast rules provided by the law regarding labor-only contracting, it is imperative to collate all the guidelines provided by the regulations and cases on the matter in order to demystify the practice and provide clear rules on permissible and prohibited labor contracting.

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[36] Philippine Exporters Confederation, Inc. (March 1997).

[37] Cesario Azucena, Jr., *Four Labor Relations Pillars For This Century*, 26 J. INTEGRATED B. PHIL. (2002), ¶ 26, *available at* http://www.ibp.org.ph/mainframe/journals/journal_xxvi/002_four_pillars.htm.

II. JUDICIAL FRAMEWORKS FOR LABOR-ONLY CONTRACTING

A. TESTS TO DISTINGUISH LABOR-ONLY CONTRACTING FROM LEGITIMATE JOB CONTRACTING

A review of labor jurisprudence from 1976 to 2003 reveals that two tests are consistently applied by the Court to distinguish labor-only contracting from legitimate job contracting: a) the statutory test and b) the "four-fold test."[38] These are not exclusive of each other, and the Court has, in fact, been applying them simultaneously in almost all its decisions. The trend of Supreme Court decisions appears to be towards the restriction and prohibition of the practice, as shown by the strict application of both tests. Accordingly, at present, a labor contractor has to pass through the eye of the needle before it may be considered a legitimate job contractor.

1. Statutory test

The statutory test simply applies the criteria set forth in the statute and its implementing regulations. Article 106 of the Labor Code provides the criteria, namely: a) the existence of capital or investment in the form of tools, equipment, machineries, work premises, among others; and b) the relation of the work performed by the contractor's employees to the principal business of the beneficiary-employer.

a. "Substantial capital or investment" test

In the 1993 decision *Neri V. NLRC*,[39] the Court initially held that to be considered a job contractor, it is enough that a contractor has substantial capital. The rationale is that article 106 of the Labor Code does not require that the contractor possess both substantial capital *and* investment in the form of tools, equipment, machineries, and work premises, among others, as shown by the use of the conjunction "or." However, this ruling was clarified in *Philippine Fuji Xerox Corp. v. NLRC*,[40] where the Court implied that a mere showing of substantial capital in itself is not enough to prove that one is an independent contractor.

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[38] In determining the existence of an employer-employee relationship, the following elements are generally considered, namely: (a) the selection and engagement of the employees; (b) the payment of wages; (c) the power of dismissal; and (d) the power to control the employees' conduct- although the latter is the most important element. San Miguel Corp. v. MAERC Integrated Services, Inc., G.R. No. 144672, 405 SCRA 579, 587, Jul. 10, 2003.

[39] Neri v. Nat'l Lab. Rel. Comm'n, G.R. No. 97008, 224 SCRA 717, Jul. 23, 1993.

[40] G.R. No. 111501, 254 SCRA 294, Mar. 5, 1996.

In the leading 2000 decision *Vinoya v. NLRC*,[41] the Court reversed *Neri* by declaring that it is not enough to show substantial capitalization or investment. It held that other factors have to be considered, such as:

> a) whether the contractor is carrying on an independent business;
> b) the nature and extent of the work;
> c) the skill required; d) the term and duration of the relationship;
> d) the right to assign the performance of specified pieces of work;
> e) the control and supervision of the workers;
> f) the power of the employer with respect to the hiring, firing and payment of the workers of the contractor;
> g) the control of the premises;
> h) the duty to supply premises, tools, appliances, materials and labor; and
> i) the mode, manner and terms of payment.

The law places the burden on the contractor to prove that it has substantial capital and other investment to qualify it as a job contractor. The complaining employees, on the other hand, need not prove the negative fact that the contractor does not have these.[42]

Moreover, *Fuji Xerox* pronounced that capital and investment in the form of tools, equipment, machineries, work premises, and other materials should be *directly related* to the services offered by the contractor.[43] Thus, a job contractor with a large capitalization and other investments could still properly be declared a labor-only contractor if these bore no relation to the services being considered. In *Fuji Xerox*, the Court declared the contractor a labor-only contractor although it had assets exceeding five million pesos and investments consisting of at least twenty typewriters, other office equipment, and service vehicles. These assets had no relation to the job for which the contractor was hired, which was to operate photocopying machines.

This judicial interpretation was adopted in Dep't Order No. 10's definition of "substantial capital or investment,"[44] and reiterated in the latest regulation, Dep't Order No. 18.[45]

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[41] G.R. No. 126586, 324 SCRA 469, Feb. 2, 2000.

[42] Guarin v. Nat'l Lab. Rel. Comm'n, G.R. No. 86010, 178 SCRA 267, Oct. 3, 1989.

[43] Philippine Fuji Xerox Corp., 254 SCRA at 304.

[44] Dep't of Lab. & Emp. (hereinafter "DOLE") Order No. 10, § 4 (e) (1997). 'Substantial capital or investment' refers to the adequacy of resources actually and directly used by the contractor or subcontractor in the performance or completion of

Lastly, under *San Miguel Corp. v. MAERC Integrated Services, Inc.*,[46] the principal employer and labor contractor should not enter into a prior agreement requiring the latter to undertake substantial capitalization and investments as a condition for the execution of a service contract. In this case, the labor-only contractor complied with the condition by borrowing from banking institutions such that its machinery, equipment and fixed assets amounted to P4,608,080.00 at the time the principal employer terminated the service contract. The Court nevertheless declared it a labor-only contractor due to the peculiar circumstances that led to the accumulation of its assets.

The Court, however, has declined to provide any benchmark amount for "substantial" capital. In *Neri*, the job contractor had a capital stock of one million pesos which was fully subscribed and paid for, and the Court held that this was substantial enough for the business of providing radio or telex and janitorial services. In *Filipinas Synthetic Fiber Corp. v. NLRC*,[47] the assets of the contractor providing janitorial services amounted to PHP1.6 million, of which PHP400,000.00 was actually subscribed. The Court described the job contractor as a highly capitalized venture that could not possibly be a labor-only contractor. *Escario v. NLRC*[48] ruled similarly when the large promotions firm engaged in providing merchandising activities presented current assets amounting to six million pesos, with an authorized capital stock of half a million pesos, plus several motor vehicles and other tools, materials and equipment.

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the job, work or service contracted out. It may refer to capital stocks and subscribed capitalization in the case of corporations, tools, equipment, implement, machineries, uniforms, protective gear, or safety devices actually used in the performance of the job, work or service contracted out. It likewise includes operating costs, administrative costs such as training and overhead costs, and such expenses as are necessary to enable the contractor or subcontractor to exercise control, supervision or direction over its employees in all aspects of performing or completing the job, service or work contracted out. The phrase, however, excludes all capital and investment the contractor or subcontractor may have which are not actually and directly used in the conduct of its business, or any gratuitous assistance, financial or otherwise, it may have received from the principal."

[45] § 5. 'Substantial capital or investment' refers to capital stocks and subscribed capitalization in the case of corporations, tools, equipment, implements, machineries and work premises, actually and directly used by the contractor or subcontractor in the performance or completion of the job, work or service contracted out."

[46] G.R. No. 144672, 405 SCRA 579, Jul.10, 2003.

[47] G.R. No. 113347, 257 SCRA 334, Jun. 14, 1996.

[48] G.R. No. 124055, 333 SCRA 257, Jun. 8, 2000.

To review the other cases, however, *Fuji Xerox* did not consider the contractor's five million pesos in assets on the ground that it had no relation at all to the services which it was providing. *San Miguel* declared the contractor a labor-only contractor although its machinery, equipment and fixed assets were valued at PHP4,608,080.00. The Court considered that the principal employer required the labor contractor to undertake such huge investments in return for a long-term service contract that would enable the latter to recoup its investments. Lastly, *Vinoya* stressed the importance of paid-up capital when it held that an authorized capital stock of P1,000,000.00 with only P75,000.00 actually paid-in cannot be considered as substantial capitalization. The contractor there provided sales representatives to an employer engaged in the business of food manufacturing and retailing.

b. "Directly related" test

Article 106 provides that "in labor-only contracting, the workers recruited and placed by the contractor are performing activities which are directly related to the principal business of the employer." The provision and the regulations, however, failed to provide a standard for "directly related." *De Leon v. NLRC*[49] supplied a test that gauged the relation between the nature of the work and the particular business in its entirety.

The issue often turns on hard questions of fact, and it is infeasible to an attempt to make a generalization. Rather, it is more fruitful to enumerate the specific activities which jurisprudence has already deemed directly related to certain specific businesses of employers:

Table 1: Activities deemed "directly related" in existing jurisprudence

Case	Activities Performed	Principal Business
Jang Lim v. NLRC[50]	milling, piling and bundling of log ends or sawn lumber, and clearing and hauling of firewood or waste firewood	production and manufacture of plywood and veneer
Vinoya v. NLRC[51]	work of a sales representative, such as booking sales orders and collecting payments	food manufacturing and sales
Tabas v. NLRC[52]	merchandising, promotion or sale of food products	manufacturing and distribution of food products

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[49] G.R. No. 70705, 176 SCRA 615, 621, Aug. 21, 1989.

[50] G.R. No. 124630, 303 SCRA 432, Feb. 19, 1999.

[51] G.R. No. 126586, 324 SCRA 469, Feb. 2, 2000.

[52] G.R. No. 80680, 169 SCRA 497, Jan. 26, 1989. *See, however,* Escario v. Nat'l Lab. Rel. Comm'n, G.R. No. 124055, 333 SCRA 257, Jun. 8, 2000.

Ponce v. NLRC[53]	buffing, quality control, assembly, and lathe machine operation	steel and metal fabrication of machine spare parts
Nat'l Power Corp. v. Court of Appeals[54]	construction of power energy facilities	power generation
Shoppers Gain Supermart v. NLRC[55]	work of merchandisers, cashiers, baggers, check-out personnel, sales ladies, and warehousemen	operation of a supermarket
Maraguinot, Jr. v. NLRC[56]	work of film and shooting crew members such as loading, unloading and arranging of movie equipment in the shooting area as instructed by the cameramen, returning the equipment to Viva Films' warehouse, and assisting in the "fixing" of the lighting system	making, distributing and exhibiting movies
Philippine School Of Business Administration-Manila, v. NLRC[57]	carpentry and plumbing work including maintaining, renovating, remodeling and repairing the school building and other facilities	operation of an educational institution
Magnolia Dairy Products Corp. v. NLRC[58]	removing "bulgings" (damaged goods) from dilapidated cartons, replacing damaged goods and re-pasting the carton thereof, disposing damaged goods or returning goods to Magnolia's warehouse to avoid bad odors, cleaning leftovers of leaking tetra-packs by mopping or washing the contaminated premises	production of tetra-pack juices and drinks.
Ecal v. NLRC[59]	sorting out lumber materials whether wet or fresh kiln as to sizes, carrying them from the stockpile to the dryer where they are loaded for drying, and unloading them after they have dried	operation of a sawmill
Philippine Fuji Xerox Corp. v. NLRC[60]	operating Xerox or copier machines	selling and leasing copier machines

[53] G.R. No. 124643, 293 SCRA 366, Sep. 29, 1998.
[54] G.R. No. 119121, 294 SCRA 209, Aug. 14, 1998.
[55] G.R. No. 110731, 259 SCRA 411, Jul. 26, 1996.
[56] G.R. No. 120969, 284 SCRA 539, Jan. 22, 1998.
[57] G.R. No. 114143, 261 SCRA 169, Aug. 28, 1996.
[58] G.R. No. 114952, 252 SCRA 483, Jan. 29, 1996.
[59] G.R. No. 92777, 195 SCRA 224, Mar. 13, 1991.
[60] G.R. No. 111501, 254 SCRA 294, Mar. 5, 1996.

Philippine Bank of Communications v. NLRC[61]	messengerial work, or the delivery of documents to designated persons whether within or without the bank premises	operation of a bank
Caurdanetaan Piece Workers Union v. Laguesma[62]	work of "cargadores" who load, unload and pile sacks of palay from the warehouse to the cargo truck	operation of a rice mill
Philippine Airlines Inc. v. NLRC[63]	work of carpenters, welders, and electricians who have been continuously working for more than one year in PAL's premises	air transportation
De Los Santos vs. NLRC[64]	janitorial services	manufacture of steel products such as LPG cylinders and drums
Asia Brewery, Inc. v. NLRC[65]	brewery plant-maintenance, janitorial, utility and relative services	beer production and distribution

c. Janitorial and security services

As early as 1990, the Court already took judicial notice of the general practice of contracting out janitorial services, even in government entities.[66] A review of jurisprudence reveals that the Court held such services directly related and integral in some cases, but not in others.

Guarin v. NLRC[67] ruled that the work of mechanics, janitors, gardeners, firemen and grass cutters were directly related to the business of garment manufacturing. The Court reasoned: "[T]he work of gardeners in maintaining clean and well-kept grounds around the factory, mechanics to keep the machines functioning properly, and firemen to look out for fires, are directly related to the daily operations of a garment factory." Likewise, the more recent *De Los Santos v. NLRC*,[68] citing *Guarin*, held that a janitor's job is directly related to the manufacture of steel products such as LPG cylinders and drums. *Asia Brewery, Inc. v. NLRC*[69] ruled similarly regarding maintenance, janitorial, utility and similar services in the employer's beer brewery.

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[61] G.R. No. 92067, 146 SCRA 347, Mar. 22, 1991.

[62] G.R. No. 113542, 286 SCRA 401, Feb. 24, 1998.

[63] G.R. No. 114775, 296 SCRA 294, Nov. 9, 1998.

[64] G.R. No. 121327, 372 SCRA 276, Dec. 20, 2001.

[65] G.R. No. 110241, 259 SCRA 185, Jul. 24, 1996. *See, however,* Filipinas Synthetic Fiber Corp. v. Nat'l Lab. Rel. Comm'n, G.R. No. 113347, 257 SCRA 334, Jun. 14, 1996.

[66] KILUSAN v. Drilon. G.R. No. 77629, 185 SCRA 190, 205, May 9, 1990.

[67] Guarin v. Nat'l Lab. Rel. Comm'n, G.R. No. 86010, 178 SCRA 267, Oct. 3, 1989.

[68] G.R. No. 121327, 372 SCRA 276, Dec. 20, 2001.

[69] G.R. No. 110241, 259 SCRA 185, Jul. 24, 1996.

Filipinas Synthetic Fiber Corp. v. NLRC, in contrast, held that although janitorial services are directly related to the principal business of manufacturing polyester fiber, such are merely incidental and not integral to it.[70] Without them, the Court reasoned, the principal's production and sales would not suffer. Likewise, *Kimberly Independent Labor Union v. Drilon* held that janitorial and yard maintenance services are not integral to the manufacture of consumer paper products and cigarette paper.[71]

Thus, janitorial and yard maintenance services are considered merely incidental to paper and polyester fiber manufacturing, but integral and essential to steel, garment, and beer production. The difference, it is argued, lies in the fact that the services may be considered integral or directly related to a certain specific business but not in an altogether different business. Thus, one could not make a generalization that janitorial services are merely incidental to all kinds of businesses. This highlights the fact that the characterization of an activity as directly related to a certain business is dependent on the nature of the work performed and its relation to the principal business scheme in its entirety. This also stresses the danger of generalizing that certain services may automatically be deemed permissible areas for job contracting.

Finally, with respect to security services, although the Supreme Court has already taken judicial notice of hiring independent contractors as early as 1983,[72] it has never declared these as incidental to all industries. Thus, security service providers may still be declared labor-only contractors if the services are directly related to the business of the principal employer and the contractor has failed the tests of an independent contractor. This was confirmed in *Vallum Security Services v. NLRC*,[73] where security guards were deemed clearly performing activities directly related to the business operations of a hotel, since the undertaking to safeguard the person and belongings of hotel guests is one of the obligations of a hotel *vis-à-vis* its guests and the general public.

2. "Four-fold" test

Beyond the statutory test, the Court has applied the "four-fold test" as an additional criterion, a test which checks for the existence of an

[70] Filipinas Synthetic Fiber Corp., 257 SCRA at 339.

[71] KILUSAN, 185 SCRA at 205.

[72] Shipside, Inc. v. Nat'l Lab. Rel. Comm'n, GR No. 50358, 118 SCRA 99, 105, Nov. 2, 1982.

[73] G.R. No. 97320, 224 SCRA 781, Jul. 30, 1993.

employer-employee relationship between the individual employees and client or principal. Such is only proper as an independent contractor-contractee relationship is characterized by the absence of such an employer-employee relationship. The true employer of the employees is the independent contractor, and the client is merely their patron, not an employer.[74]

As early as 1976, in *Mafinco Trading Corp. v. Ople*,[75] the Supreme Court applied the four-fold test by considering the following elements determinative of an employer-employee relationship's existence:

(1) the selection and engagement of the employees;
(2) the payment of wages;
(3) the power of dismissal; and
(4) the power to control the employees' conduct.

The last is the most important element. Thus, the "control test" is the leading test used by the Court. The power of control simply refers to the employer's authority to control the employee not only with regard to the result of the work to be done, but also with regard to the means and methods by which the work is to be accomplished. The power need not actually be exercised; its mere existence in the relationship suffices.[76] This was seen, for example, in *Sara v. Agarrado*,[77] which held:

> Private respondent was an independent contractor, who exercising independent employment, contracted to do a piece of work according to her own method and without being subject to the control of her employer except as to the result of her work. She was paid for the result of her labor, unlike an employee who is paid for the labor he performs.[78]

Finally, the contract's language is not determinative of the parties' relationship, and the test hinges on the totality of the facts and surrounding circumstances of each case.[79]

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[74] Tabas v. Nat'l Lab. Rel. Comm'n, G.R. No. 80680, 169 SCRA 497, 503, Jan. 26, 1989.

[75] G.R. 37790, 70 SCRA 139, Mar. 25, 1976.

[76] Zanotte Shoes vs. Nat'l Lab. Rel. Comm'n, G.R. No. 100665, 241 SCRA 261, Feb. 13, 1995; Tiu vs. Nat'l Lab. Rel. Comm'n, G.R. No. 95845, 254 SCRA 1, Feb. 21, 1996.

[77] G.R. No. 73199, 166 SCRA 625, Oct. 26, 1988.

[78] *Id.* at 631.

[79] Tabas, 169 SCRA at 500.

How the workers' wages are paid to them is another critical factor in the four-fold test. This was declared by *Social Security System v. Court of Appeals*,[80] which emphasized that in a truly independent contractor-contractee relationship, the fees are paid directly to the manpower agency in lump sum without indicating or implying that the basis of such lump sum is the salary per worker multiplied by the number of workers assigned to the company.[81] In *Jang Lim v. NLRC*,[82] the Court took judicial notice of employers' practice of not issuing pay slips directly to their employees in order to evade their obligations under the Labor Code. Thus, in *Vinoya v. NLRC*, the principal employer was declared to be the true employer although it was established that the labor-only contractor had been paying the workers' wages:

> Under the current practice, a third person, usually the purported contractor (service or manpower placement agency), assumes the act of paying the wage. For this reason, the lowly worker is unable to show proof that it was directly paid by the true employer. Nevertheless, for the workers, it is enough that they actually receive their pay, oblivious of the need for pay slips, unaware of its legal implications. Applying this principle to the case at bar, even though the wages were coursed through PMCI, we note that the funds actually came from the pockets of RFC. Thus, in the end, RFC is still the one who paid the wages of petitioner albeit indirectly.[83]

The last two elements, namely the power of dismissal and hiring, are self-explanatory.

3. Summary framework and badges of labor-only contracting

Collating the criteria provided by jurisprudence, one summarizes:

1) Whether or not the contractor has substantial capitalization or investment in the form of tools, equipment, machineries and work premises, among others, which are directly and actually related to the services contracted out;

2) Whether or not the contractor is carrying on an independent business;

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[80] G.R. No. 26146, 39 SCRA 629, Oct. 31, 1969.

[81] *Id.* at 635.

[82] G.R. No. 124630, 303 SCRA 432, 447, Feb. 19, 1999.

[83] Vinoya v. Nat'l Lab. Rel. Comm'n, G.R. No. 126586, 324 SCRA 469, 486, Feb. 2, 2000.

3) The nature and extent of the work;

4) The skill required;

5) The term and duration of the relationship;

6) The right to assign the performance of specified pieces of work;

7) The power of the employer with respect to the hiring, firing and payment of the workers of the contractor;

8) The control of the premises;

9) The duty to supply premises, tools, appliances, materials and labor;

10) The mode, manner and terms of payment; and

11) The control and supervision of the workers; which is the most determinative of all.

Beyond these theoretical criteria, jurisprudence is replete with what the Court has described as indicia of labor-only contracting. These "badges" are by-products of the Court's application of its tests and may serve as presumptions of the existence of labor-only contracting. These thus lay the foundation for further guidelines, and are collated as:

1) The subcontractor or contractor does not have a license to engage in subcontracting or independent contracting.[84] Independent contractors are licensed.

2) The workers use the principal employer's tools and equipment in their work.[85] Independent contractors provide their own tools.

3) The principal employer required the labor-only contractor to undertake substantial capitalization and investments as a condition for the execution of a long-

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[84] Sandoval Shipyards, Inc v. Pepito, G.R. No. 143428, 359 SCRA 555, 561, Jun. 25, 2001.

[85] Sandoval Shipyards, 359 SCRA at 561; Ponce, 293 SCRA at 375.

term service contract that would enable the latter to recoup its investments.[86] An independent contractor has substantial capital and investments at the very start of the contractor-contractee relationship.

4) The contractor's workers were never assigned to any other establishment.[87] An independent contractor's workers can work when and for whom he or she chooses, usually on a part time basis, and the contractor himself usually makes his services available to the general public.

5) Workers were confined to the work premises throughout the performance of their duties for the day, until shop closing time.[88] An independent contractor generally controls his own work time.

6) The employer-employee relationship between the labor contractor and its worker was established in anticipation of, and for the very purpose of making possible, the assignment of the worker to the principal employer.[89] An independent contractor is the direct employer of its employees and does not supply its employees to others.

7) The workers were already working with the principal employer before they were purportedly hired by one job contractor after another for many years, and they were regularly assigned to perform the same jobs in the premises of the principal employer.[90] An independent contractor can work when and for whom he or she chooses; usually on a part time basis.

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[86] Sandoval Shipyards, 359 SCRA at 561; Ponce, 293 SCRA at 375.

[87] Philippine Fuji Xerox Corp. v. Nat'l Lab. Rel. Comm'n, G.R. No. 111501, 254 SCRA 294, 299, Mar. 5, 1996.

[88] Broadway Motors, Inc. v. Nat'l Lab. Rel. Comm'n, G.R. No. 78382, 156 SCRA 522, 529, Dec. 14, 1987.

[89] Philippine Bank of Comm'ns v. Nat'l Lab. Rel. Comm'n, G.R. No. 92067, 146 SCRA 347, 353, Mar. 22, 1991.

[90] Philippine School of Bus. Admin.-Manila v. Nat'l Lab. Rel. Comm'n, G.R. No. 114143, 261 SCRA 169, 193, Aug. 28, 1996.

8) The principal employer hired the workers and then placed them under their respective subcontractors.[91] An independent contractor has its own employees at the very outset, and these employees' skills are usually specialized.

9) The principal employer does not remit a lump sum to the labor-only contractor as payment for the workers' services but merely gives a fixed fee or commission.[92] An independent contractor is usually paid a lump sum for the completion of the job on commission or percentage basis.

10) The principal employer assumed the responsibility of paying for overtime, holiday, rest day, 13th month, and incentive leave pay, maternity benefits, and other legally mandated payments, including the employer's share of the SSS and Medicare contributions.[93] An independent contractor assumes responsibility for the payment of all its employees' benefits.

11) The workers were made liable directly to the principal employer for any loss or damage, with the latter directly deducting such amounts for loss or damage from their salaries.[94] The employees of an independent contractor are liable to it and any damage or loss caused by its employees will be borne by it as their direct employer.

12) The right to control and supervise the means and methods by which the work shall be effected is reserved or actually exercised by the principal employer, whether solely or jointly with the contractor.[95] Independent contractors exercise independence and control over the means and methods by which they would finish the

[91] Caurdanetaan Piece Workers Union v. Laguesma, G.R. No. 113542, 286 SCRA 401, 423, Feb. 24, 1998.

[92] Philippine School of Bus. Admin., 261 SCRA at 193.

[93] San Miguel Corp. v. MAERC Integrated Services, Inc., G.R. No. 144672, 405 SCRA 579, 588, Jul.10, 2003.

[94] Philippine School of Bus. Admin., 261 SCRA at 193.

[95] Vallum Security Services v. Nat'l Lab. Rel. Comm'n, G.R. No. 97320, 224 SCRA 781, 787, Jul. 30, 1993.

work. They are given an assignment and left to accomplish it.

13) Workers were required by the principal employer not only to keep regular working hours, but to render overtime service as well when necessary either because of the volume or immediacy of the work.[96] An independent contractor generally controls his own work time.

14) Workers were expressly required to abide by the principal employer's regulations and policies, particularly those regarding uniforms and the display of identification cards.[97] An independent contractor provides its own rules for employees. However, this indicia does not extend to ID cards issued to a contractor's workers merely to facilitate entry into a client's premises.[98]

15) The contractor undertakes to assist the principal employer in making sure that the daily time records of its alleged employees faithfully reflect the actual working hours.[99] Independent contractors report on work progress as goals are met and when the job is finished.

16) Work was performed during regular working hours six days a week, making it impossible for them to carry on any additional and independent business outside the premises of petitioner.[100] An independent contractor generally controls his own work time and makes his or her services available to the general public.

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[96] Vinoya v. Nat'l Lab. Rel. Comm'n, G.R. No. 126586, 324 SCRA 469, 482, Feb. 2, 2000.

[97] Sandoval Shipyards, 359 SCRA at 561.

[98] Asim v. Castro, G.R. Nos. 75063, 163 SCRA 344, 348, Jun. 30, 1988.

[99] Vallum Security, 224 SCRA at 788.

[100] Associated Anglo-American Tobacco Corp. v. Clave, G.R. No. 50915, 189 SCRA 127, 133, Aug. 30, 1990.

17) The principal employer actually exercises the power of enforcing disciplinary measures over the workers, although the contrary was provided in the contract.[101]

18) The principal employer exercises the right to dismiss the workers.[102] A contractee may take action to rescind a contract or renegotiate it with a contractor, or perhaps complain to the contractor regarding a particular employee. He may not, however, take direct action against a contractor's employee.

19) The contractor was specifically set up only to meet the pressing need of its principal as evidenced by the fact that none of its workers was ever assigned to any other establishment.[103] An independent contractor provides his or her services to several persons or firms at the same time.

20) The workers supplied are performing activities which are directly related or usually necessary or desirable to the principal business of the employer.[104] An independent contractor performs a specific undertaking which is coterminous with the duration of the project and the activities performed are not usually necessary or desirable to the principal business of the principal.

B. LABOR-ONLY CONTRACTING V. LEGITIMATE JOB CONTRACTING

Under article 106, any person who enters into an agreement with a job contractor, either for the performance of a specified work or for the supply of manpower, assumes responsibility over the employees of the latter. However, for the purpose of determining the extent of the principal employer's liability, the law makes a distinction between legitimate job contracting and labor-only contracting.

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[101] Vallum Security, 224 SCRA at 787.

[102] *Id.* at 787.

[103] *Id.* at 789.

[104] Shoppers Gain Supermart v. Nat'l Lab. Rel. Comm'n, G.R. No. 110731, 259 SCRA 411, 419-20, Jul. 26, 1996.

In legitimate job contracting, no employer-employee relationship exists between the contractor's employees and the principal. Nevertheless, the principal employer becomes jointly and severally liable with the job contractor for the payment of the employees' wages whenever the contractor fails to pay the same. In such case, the law creates an employer-employee relationship between the principal and the contractor's employees for the limited purpose of ensuring that the employees are paid their wages. The principal is not responsible for any other employee claims.[105]

On the other hand, in cases of labor-only contracting, an employer-employee relationship is created by law between the principal and the labor-only contractor's employees. In this case, the labor-only contractor is considered a mere agent. The principal is responsible to the employees as if he had directly employed them, and therefore becomes solidarily liable with the labor-only contractor for all the employees' rightful claims.[106]

Thus, in legitimate job contracting, the principal is considered only an indirect employer.[107] There are therefore three parties involved in legitimate job contracting, forming a trilateral employment relationship:

a. The principal, who decides to farm out a job to a subcontractor;

b. The subcontractor, who has the capacity to independently undertake the performance of the job or service; and

c. The employees, engaged by the subcontractor to accomplish the job or service.

On the other hand, in labor-only contracting, the principal is considered the direct employer.[108] There are actually only two parties involved: the employer and the employees supplied by the labor-only contractor.

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[105] Philippine Bank of Comm'ns v. Nat'l Lab. Rel. Comm'n, G.R. No. 92067, 146 SCRA 347, 359, Mar. 22, 1991.

[106] *Id.* at 359; Tabas v. Nat'l Lab. Rel. Comm'n, G.R. No. 80680, 169 SCRA 497, 502, Jan. 26, 1989.

[107] LAB. CODE, art. 107.

[108] Art. 106.

The distinction between a legitimate contractor and a labor-only contractor therefore assumes greater significance when a party to the contract or a worker covered by the arrangement seeks to enforce his rights against another party. The applicable laws and even the body with jurisdiction are different. The former is governed by the ordinary rules on obligations and contracts and the regular courts have jurisdiction, except in cases where an independent contractor fails to pay its employees' wages. The latter is governed by labor laws and labor tribunals have jurisdiction.

C. EFFECTS OF A FINDING THAT LABOR-ONLY CONTRACTING EXISTS

A review of Supreme Court decisions from 1976 to 2003 reveals a variety of unscrupulous practices employed by crafty businessmen. Thus, as the guardian of workers' rights, the Supreme Court took the cudgels for the workers by striking where it would hurt such employers most: at their pockets. As gleaned from jurisprudence, the existing Labor Code provisions already form an aegis against exploitation:

> Art. 106. *Contractor or subcontractor.* – Whenever an employer enters into a contract with another person for the performance of the former's work, the employees of the contractor and of the latter's subcontractor, if any, shall be paid in accordance with the provisions of this Code.
>
> In the event that the contractor or subcontractor fails to pay the wages of his employees in accordance with this Code, the employer shall be jointly and severally liable with his contractor or subcontractor to such employees to the extent of the work performed under the contract, in the same manner and extent that he is liable to employees directly employed by him.
>
> The Secretary of Labor and Employment may, by appropriate regulations, restrict or prohibit the contracting-out of labor to protect the rights of workers established under this Code. In so prohibiting or restricting, he may make appropriate distinctions between labor-only contracting and job contracting as well as differentiations within these types of contracting and determine who among the parties involved shall be considered the employer for purposes of this Code, to prevent any violation or circumvention of any provision of this Code.
>
> There is *"labor-only"* contracting where the person supplying workers to an employer does not have substantial capital or investment in the form of tools, equipment, machineries, work premises, among others, and the workers recruited and placed by such person are performing activities which are directly related to the

principal business of such employer. In such cases, the person or intermediary shall be considered merely as an agent of the employer who shall be responsible to the workers in the same manner and extent as if the latter were directly employed by him.

Art. 107. *Indirect employer.* - The provisions of the immediately preceding article shall likewise apply to any person, partnership, association or corporation which, not being an employer, contracts with an independent contractor for the performance of any work, task, job or project.

Art. 109. *Solidary liability.* – The provisions of existing laws to the contrary notwithstanding, every employer or indirect employer shall be held responsible with his contractor or subcontractor for any violation of any provision of this Code. For purposes of determining the extent of their civil liability under this Chapter, they shall be considered as direct employers.

A finding that a contractor is a labor-only contractor is equivalent to a finding an employer-employee relationship between the principal and contractor's employees exists, as prescribed by the law itself.[109] Again, the principal is responsible as it had directly employed such employees.[110] Consequently, it must bear all an employer's obligations, though it may seek reimbursement from the contractor for half of what it paid to the employees, assuming of course that the contractor has sufficient assets.

Note that these liabilities go beyond wages and other amounts required by labor laws. In *National Power Corp. v. CA*, for example, the Court held that a principal's liability extends to injuries resulting from employees' tortious acts.[111] Again, this is consistent with the rule that the principal is treated as the direct employer.[112]

To cite another example, a finding of labor-only contracting may also confer regular status on an employee if he performed activities directly related to the principal's business, in addition to determining that an

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[109] Industrial Timber Corp. v. Nat'l Lab. Rel. Comm'n, G.R. No. 83616, 169 SCRA 341, 349, Jan. 20, 1989.

[110] Nat'l Power Corp. v. Court of Appeals, G.R. No. 119121, 294 SCRA 209, 218, Aug. 14, 1998.

[111] *Id.* at 216; CIVIL CODE, art. 2180. "Employers shall be liable for the damages caused by their employees and household helpers acting within the scope of their assigned tasks, even though the former are not engaged in any business or industry."

[112] Associated Anglo-American Tobacco Corp. v. Clave, G.R. No. 50915, 189 SCRA 127, 133, Aug. 30, 1990.

employer-employee relationship with the principal exists. Such employees are deemed regular employees from the very start of the relationship. Further, even employees hired as casuals or not performing activities directly related to the business will be considered regular with respect to the activity in which they are employed after rendering more than one year of service, whether such service is continuous or not.[113] However, rules governing probationary, contractual, and casual employees still apply, and it is emphasized that conferment of regular status is never automatic despite a finding that labor-only contracting exists.

Next, workers may also be entitled to hold a certification election. This may occur where the employees of the labor-only contractor seek to organize a union in an unorganized establishment, but are prevented from doing so by the principal employer on the ground that they are not its employees.[114] This would also occur in case a labor-only contractor's workers seek to challenge an incumbent bargaining agent.[115] Moreover, the employer would be held liable for unfair labor practice if it attempts to

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[113] LAB. CODE, art. 280. "*Regular and Casual Employment.* – The provisions of written agreement to the contrary notwithstanding and regardless of the oral agreement of the parties, an employment shall be deemed to be regular where the employee has been engaged to perform activities which are usually necessary or desirable in the usual business or trade of the employer, except where the employment has been fixed for a specific project or undertaking the completion or termination of which has been determined at the time of the engagement of the employee or where the work or services to be performed is seasonal in nature and the employment is for the duration of the season.

"An employment shall be deemed to be casual if it is not covered by the preceding paragraph: *Provided*, That, any employee who has rendered at least one year of service, whether such service is continuous or broken, shall be considered a regular employee with respect to the activity in which he is employed and his employment shall continue while such activity exists."

[114] Caurdanetaan Piece Workers Union v. Laguesma, G.R. No. 113542, 286 SCRA 401, 426, Feb. 24, 1998; LAB. CODE, art. 257. "*Petitions in unorganized establishments.* – In any establishment where there is no certified bargaining agent, a certification election shall automatically be conducted by the Med-Arbiter upon the filing of a petition by a legitimate labor organization."

[115] Art. 256. "*Representation issue in organized establishments.* – In organized establishments, when a verified petition questioning the majority status of the incumbent bargaining agent is filed before the Department of Labor and Employment within the sixty-day period before the expiration of the collective bargaining agreement, the Med-Arbiter shall automatically order an election by secret ballot when the verified petition is supported by the written consent of at least twenty-five percent (25%) of all the employees in the bargaining unit to ascertain the will of the employees in the appropriate bargaining unit."

prevent the labor-only contractor's workers from forming a union by replacing them with non-union members through an outsourcing agreement.[116] Lastly, if labor-only contracting is undertaken by a legitimate labor organization, a petition for cancellation of union registration may be filed against it.[117]

Moreover, employees must be accorded security of tenure. Regular employees can be terminated only based on "just" and "authorized" causes under articles 282,[118] 283[119] and 284[120] of the Labor Code and following

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[116] Art. 248. "*Unfair labor practices of employers.* – It shall be unlawful for an employer to commit any of the following unfair labor practice:

"(a) To interfere with, restrain or coerce employees in the exercise of their right to self-organization;

...

"(c) To contract out services or functions being performed by union members when such will interfere with, restrain or coerce employees in the exercise of their rights to self-organization."

[117] Art. 239(e). "*Grounds for cancellation of union registration.* – The following shall constitute grounds for cancellation of union registration:

...

"(e) Acting as a labor contractor or engaging in the '*cabo*' system, or otherwise engaging in any activity prohibited by law."

[118] Art. 282. Termination by employer. — An employer may terminate an employment for any of the following causes:

(a) Serious misconduct or willful disobedience by the employee of the lawful orders of his employer or representative in connection with his work;

(b) Gross and habitual neglect by the employee of his duties;

(c) Fraud or willful breach by the employee of the trust reposed in him by his employer or duly authorized representative;

(d) Commission of a crime or offense by the employee against the person of his employer or any immediate member of his family or his duly authorized representative; and

(e) Other causes analogous to the foregoing.

[119] Art. 283. "Closure of establishment and reduction of personnel. - The employer may also terminate the employment of any employee due to the installation of labor saving devices, redundancy, retrenchment to prevent losses or the closing or cessation of operation of the establishment or undertaking unless the closing is for the purpose of circumventing the provisions of this Title, by serving a written notice on the workers and the Ministry of Labor and Employment at least one (1) month before the intended date thereof. In case of termination due to the installation of labor saving devices or redundancy, the worker affected thereby shall be entitled to a separation pay equivalent to at least his one (1) month pay or to at least one (1) month pay for every year of service, whichever is higher. In case of retrenchment to prevent losses and in cases of closures or cessation of operations of establishment or undertaking not due to serious business losses or financial reverses, the separation pay shall be equivalent to one (1)

both substantive and procedural due process requirements for a lawful dismissal.[121]

Termination without just cause will make the employer-beneficiary liable for the employee's reinstatement and back wages or separation pay.[122] In case of dismissal for just cause but with failure to comply with the procedural requirements, the beneficiary-employer may still be held liable for damages under the Civil Code as are duly proven.[123] In case of termination based on authorized causes but with failure to comply with notice requirements, it could likewise be held liable for damages.[124]

Moreover, the burden of proving that substantive and procedural due process requirements were satisfied rests on the employer-beneficiary. It cannot interpose that the dismissal was due to the expiration or completion of contract for this is not a ground for termination allowed by law.[125] If the employer-beneficiary is a corporation, the workers may still sue the responsible officers for payment of backwages, even after the corporation's dissolution.[126]

Finally, with respect to a principal's solidary liability with the labor-only contractor, it cannot invoke a provision in the service contract that the

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month pay or at least one-half (1/2) month pay for every year of service, whichever is higher. A fraction of at least six (6) months shall be considered one (1) whole year."

[120] Art. 284. "Disease as ground for termination. – An employer may terminate the services of an employee who has been found to be suffering from any disease and whose continued employment is prohibited by law or is prejudicial to his health as well as to the health of his co-employees: *Provided*, That he is paid separation pay equivalent to at least one (1) month salary or to one-half (1/2) month salary for every year of service, whichever is greater, a fraction of at least six (6) months being considered as one (1) whole year."

[121] Thus, the dismissal must be for a valid or authorized cause, and the requirements of notice and hearing must likewise be observed before an employee may be dismissed. Art. 279, 281, 282-84; Salaw v. Nat'l Lab. Rel. Comm'n, G.R. No. 90786, 202 SCRA 7, 11 Sep. 27, 1991.

[122] Sandoval Shipyards, Inc v. Pepito, G.R. No. 143428, 359 SCRA 555, 561, Jun. 25, 2001

[123] Agabon v. Nat'l Lab. Rel. Comm'n, G.R. No. 158693, Nov. 17, 2004.

[124] Magnolia Dairy Products Corp. v. Nat'l Lab. Rel. Comm'n, G.R. No. 114952, 252 SCRA 483, Jan. 29, 1996.

[125] *Id.* at 491.

[126] Gudez v. Nat'l Lab. Rel. Comm'n, G.R. No. 83023, 183 SCRA 644, Mar. 23, 1990; A.C. Ransom Labor Union-CLU v. Nat'l Lab. Rel. Comm'n, G.R. No. 69494, 142 SCRA 269, Jun. 10, 1986.

labor-only contractor specifically agrees to be solely responsible for all liabilities.[127]

However, note that in terms of penalties, the law only provides for the creation of a direct employer-employee relationship between the principal and the contractor's employees. Thus, a Labor Arbiter has no authority to further penalize a principal by awarding back wages to workers who had been validly dismissed due to redundancy, and may only award separation pay. *Philippine Airlines, Inc. v. NLRC* pointed out:

> Public respondents' position is without legal basis. Since private respondents were validly dismissed under Art. 283, they are not entitled to back wages. Apparently, public respondents awarded back wages to private respondents to penalize PAL for engaging in a "labor-only" scheme. However, the law does not give public respondents such authority. The only effect of labor-only contracting is that "the person or intermediary shall be considered merely as an agent of the employer who shall be responsible to the workers in the same manner and extent as if the latter were directly employed by him" (Art. 106, Labor Code).[128]

Neither is there any provision for penal sanctions for labor-only contracting, even if it is expressly prohibited by regulations issued by the Secretary of Labor.

D. FORBIDDEN AND PERMISSIBLE AREAS OF LABOR CONTRACTING

After defining labor-only contracting and elucidating the tests used to determine its existence, it is only proper to enumerate the areas of contracting already determined by the Court as permissible, in order to guide employers, contractors, executive officials, and legislators. The areas which are impermissible because they have been declared as directly related to certain principal businesses, have already been listed in a previous section.

The table below enumerates some of the services which may be validly contracted out by employers engaged in certain specific businesses. In all these instances, the labor contractors satisfied all the requirements of an independent contractor. This only means that the Court's declaration of the activities as permissible areas of job contracting was premised on an

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[127] Philippine Airlines, Inc. v. Nat'l Lab. Rel. Comm'n, G.R. No. 114775, 296 SCRA 214, 233, Sep. 25, 1998.

[128] *Id.* at 233.

initial finding that the labor contractors fulfilled all the requirements of an independent contractor.

Table 2: Permissible areas for job contracting in existing jurisprudence

Case	Services	Main Business
Coca-Cola Bottlers, Phils., Inc. v. Hingpit[129]	services of bottling crew and utility workers	bottling, distribution and sale of soft drink products
Neri v. NLRC[130]	services of radio/telex operators	operation of a bank
Escario v. NLRC[131]	promotions and merchandising activities	food manufacturing or distributing
Kimberly Independent Labor Union v. Drilon[132]	janitorial and yard maintenance services	manufacturing consumer paper products and cigarette paper
Filipinas Synthetic Fiber Corp. v. NLRC[133]	janitorial services	manufacturing polyester fiber
Baguio v. NLRC[134]	construction of an annex building	flour and feeds manufacturing
Singer Sewing Machine Co. v. Drilon[135]	services of collecting agents	distribution and sale of sewing machines
Escaño, Inc. v. NLRC[136]	stevedoring and *arrastre* services	shipping business
Bordeos *v. NLRC*[137]	repair, maintenance, and installation services on pipelines and other structures of a geothermal plant	exploration and exploitation of geothermal resources

Again, as early as 1990, the Court already took judicial notice of practices regarding janitorial and security services.[138] From the previous discussion, these may not automatically be deemed areas of permissible contracting because they may be considered directly related to certain

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[129] G.R. No. 127238, 294 SCRA 594, Aug. 25, 1998.

[130] G.R. No. 97008, 224 SCRA 717, Jul. 23, 1993.

[131] G.R. No. 124055, 333 SCRA 257, Jun. 8, 2000.

[132] KILUSAN v. Drilon. G.R. No. 77629, 185 SCRA 190, May 9, 1990. *See, however,* Asia Brewery, Inc. v. Nat'l Lab. Rel. Comm'n, G.R. No. 110241, 259 SCRA 185, Jul. 24, 1996

[133] Filipinas Synthetic Fiber Corp. v. Nat'l Lab. Rel. Comm'n, G.R. No. 113347, 257 SCRA 334, Jun. 14, 1996.

[134] G.R. No. 79004, 202 SCRA 465, Oct. 4, 1991.

[135] G.R. No. 91307, 190 SCRA 270, Jan. 24, 1991.

[136] G.R. No. 59229, 201 SCRA 63, Aug. 22, 1991.

[137] G.R. No. 115314, 262 SCRA 424, Sep. 26, 1996.

[138] Rhone-Pholenc Agrochemicals Phil., Inc. v. Nat'l Lab. Rel. Comm'n. G.R. No. 102633, 217 SCRA 249, Jan. 19, 1993; Shipside, Inc. v. Nat'l Lab. Rel. Comm'n, GR No. 50358, 118 SCRA 99, Nov. 2, 1982.

businesses such as garments and steel manufacturing in the case of janitors, and hotels, in the case of security guards.

III. EXECUTIVE ACTIONS ON LABOR-ONLY CONTRACTING

Pursuant to its delegated power to prohibit or restrict labor-only contracting, the Secretary of Labor has issued four regulations,[139] all of which expressly prohibit the practice. First, the Secretary issued regulations implementing the Labor Code, including those governing subcontracting arrangements.[140] In 1997, Dep't Order No. 10 superseded these regulations, and was in turn revoked by Dep't Order No. 3 in 2001. Finally, in 2002, this was replaced by Dep't Order No. 18, which remains the regulation in force today.

A. LABOR CODE IMPLEMENTING RULES AND REGULATIONS

The Labor Code's Implementing Rules and Regulations ("IRR") were issued in 1974 after the Labor Code took effect, and primarily dealt with:

a) Enforcing civil liability in cases when the contractor or subcontractor failed to pay the wages due their employees;[141]

b) Prescribing the conditions when permissible contracting is allowed;[142] and

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[139] DOLE Implementing Rules and Regulations (1987) (hereinafter "Lab. Code IRR"); DOLE Order No. 10 (1997); DOLE Order No. 3 (2001); DOLE Order No. 18 (2002).

[140] LAB. CODE IRR, book 3, chap. IV, Rule 8, §§ 7-9.

[141] § 7. "*Civil Liability of employer and contractors.* – Every employer or indirect employer shall be jointly and severally liable with his contractor or subcontractor for the unpaid wages of the employees of the latter. Such employer or indirect employer may require the contractor or subcontractor to furnish a bond equal to the cost of labor under contract on condition that the bond will answer for the wages due the employees should the contractor or subcontractor, as the case may be, fail to pay the same."

[142] § 8. "*Job Contracting.* – There is job contracting permissible under the Code if the following conditions are met: (1) The contractor carries on an independent business and undertakes the contract work on his own account under his own responsibility according to his own manner and method, free from the control and direction of his employer or principal in all matters connected with performance of the work except as

c) Providing for a definition of what constitutes labor-only contracting and the consequences thereof should such arrangements exist in the workplace.[143]

The Secretary of Labor was given the duty to balance the employer and worker interests, with the latter granted a primordial consideration.[144] He was empowered "to determine through appropriate orders whether or not the contracting out of Labor is permissible in light of the circumstances of each case and after considering the operating needs of the employer and the rights of the workers involved. In such case, he may prescribe conditions and restrictions to insure the protection and welfare of the workers."[145]

B. DEPARTMENT ORDER NO. 10

Dep't Order No. 10 remains the most controversial order issued by the Secretary to date. This order was issued in 1997 supposedly to meet the imperative need of employers for labor flexibility brought about by stiff global competition and the 1997 economic crisis. Among its significant provisions are:

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to the results thereof; and (2) the contractor has substantial capital or investment in the form of tools, equipment, machineries, work premises, and other materials which are necessary in the conduct of his business."

[143] § 9. "*Labor-only contracting.* – (a) Any person who undertakes to supply workers to an employer shall be deemed to be engaged in labor-only contracting when such person: (1) does not have substantial capital or investment in the form of tools, equipment, machineries, work premises, and other materials; and (2) the workers recruited and placed by such person are performing activities which are directly related to the principal business or operations of the employer in which workers are habitually employed. (b) Labor-only contracting as defined herein is hereby prohibited and the person acting as contractor shall be considered merely as an agent or intermediary of the employer who shall be responsible to the workers in the same manner and extent as if the latter were directly employed by him. (c) For cases not falling under this Article, the Secretary of Labor shall determine through appropriate orders whether or not contracting out of labor is permissible in the light of the circumstances of each case and after considering the operating needs of the employer and the rights of the workers involved. In such case, he may prescribe conditions and restrictions to insure the protection and welfare of the workers."

[144] Levy Ang, Sentro ng Alternatibong Lingap Panligal ("SALIGAN"), Executive Action on Subcontracting: Past and Future (Jul. 25, 2001) (unpublished paper on file with the authors).

[145] LAB. CODE IRR, book 3, chap. IV, Rule 9, § 9 (c).

(1) Express enumeration of specific activities constituting permissible contracting;

(2) Enumeration of what constitutes the prohibited acts in subcontracting;

(3) Procedure for registration of subcontractors;

(4) Express definition of substantial capital or investment; and;

(5) Defining what constitutes unfair labor practice in subcontracting.

It incorporated the conditions enumerated under the IRR as to when contracting is permissible and added a new one, that the principal and contractor or subcontractor should also agree that the contractual employees' entitlement to all labor and occupational safety and health standards, free exercise of the right to self-organization, security of tenure and social and welfare benefits will not be impaired. However, this addition proved ineffective, as no contracting arrangements were declared illegitimate or invalidated for non-compliance with it.

Though intended to prohibit labor-only contracting, the new regulation instead liberalized the practice by expressly permitting seven forms of contracting or subcontracting:

(1) Jobs or services that are necessary to meet the abnormal rises in demand of products or services where the regular work force is not enough;

(2) Occasional jobs or services that require experts or highly technical individuals;

(3) Services that are intended only for the promotion of new products allowable within duration of promotional period;

(4) Services that are not directly related to the main business or operation of the principal;

(5) Merchandising work or public display of manufacturer's products that does not include selling and issuance of receipt or invoice;

(6) Specialized work that require unusual or peculiar skills, tools or equipment; and

(7) Substitute services, like relievers, contracted just for the duration of time a regular employee is absent.

The main criticism against listing specific tasks as permissible areas is that it creates the impression that such tasks may be contracted out under any circumstances. Thus, even if the subcontracting arrangement violates rules against labor-only contracting, security of tenure, or coverage of existing collective bargaining agreements, it takes on a semblance of legitimacy.[146]

In the year Dep't Order No. 10 was issued, the number of agencies in the subcontracting business increased by more than half. Five workers were employed on a temporary or irregular basis for every new worker hired as a regular employee. Further, the average number of subcontractors ranged from two to three per principal firm. Since that time, the "casualization" of labor accelerated.

According to Atty. Levy Ang of Sentro ng Alternatibong Lingap Panligal ("SALIGAN"),[147] numerous labor groups condemned the order as it "practically opened the floodgates for rampant contractualization so that even positions previously held by regular employees were taken over by contractual employees."[148] In 1997, 598,000 workers, or 20.9% of the total number of workers employed were part-time, casual or contractual workers. This represented a 13.7% increase over the 1989 figure of 359,000. Even during robust from 1992 to 1996, the proportion of non-agricultural workers under flexible contracts rose from 15.6% to 18.4%. Significantly, the construction industry had the highest proportion of workers under flexible arrangements; in 1997, 59% of constructions laborers were contractual and 5.6% were casual workers.[149]

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[146] Ang, *supra* note 144.
[147] "Center for Alternative Legal Aid."
[148] Ang, *supra* note 144.
[149] *Id.*.

The increase in the number of contractual workers was accompanied by a corresponding decrease in the number of regular workers. This led to a decrease in the number of union members, and invariably, to a decrease in union collective bargaining strength across industries. In fact, the Department of Labor reported:

> The annual growth rate of unions has declined in seven out of the last ten years. The number of new unions in 1990 increased by less than one percent over the previous year, but in 1998 it decreased by 20%. There were 628 unions formed in 1990, compared to only 330 in 1998. This accretion is the lowest since 1985.[150]

Another added feature of Dep't Order No. 10 was its procedure for the registration of contractors. Unfortunately, this was effectively diluted by another of its provisions expressly stating that such registration is not to be regarded as a condition *sine qua non*, and its purpose was only to provide effective labor market information in subcontracting. The lack of an effective sanction for non-compliance made this registration feature ineffective, and mere delisting was not a sufficient deterrent. Moreover, the burden of proving that a subcontractor was illegitimate or illegal was left by the Order on the person claiming this.

Numerous workers' groups called on the government to revoke Dep't Order NO. 10 even if it ostensibly allowed firms to use contractual workers for specific and, in most cases, unusual or emergency situations only, such as a sudden surge of demand for a company's products which the company's regular employees could not meet. The Order proved disastrous to workers because many companies used its provisions to circumvent laws against contractualization and to justify labor-only contracting in order to cut production costs at the expense of workers' welfare.[151]

C. DEPARTMENT ORDER NO. 3

Dep't Order No. 3 was issued on May 8, 2001 in response to this clamor. It continued the prohibition against labor-only contracting, and gave government, workers and employers the opportunity to shape a new and more responsive set of rules through the Tripartite Industrial Peace Council. Its important features are:

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[150] DOLE, TRENDS AND EMERGING ISSUES ON LABOR AND EMPLOYMENT (2000).

[151] Ernesto Herrera, *Don't Blame Me for Contractualization*, MANILA TIMES, Jan. 9, 2003, ¶ 10, *available at* http://www.manilatimes.net/national/2003/jan/09/opinion/20030109opi5.html.

(1) It prohibits labor-only contracting;

(2) It recognizes the validity of contracts entered into when Department Order No. 10 was still in force;

(3) It is a temporary measure; and

(4) It sets process and mechanism, that is, consultations through the Tripartite Industrial Peace Council ("TIPC") by which a new set of rules shall be formulated.[152]

Section 2 stated that there is labor-only contracting where the contractor or subcontractor merely recruits, supplies or places workers to perform a job, work or service for a principal, and the following elements are present:

(1) The contractor or subcontractor does not have substantial capital or investment to actually perform the job, work or service under its own account and responsibility; and

(2) The employees recruited, supplied or placed by such contractor or subcontractor are performing activities directly related to the main business of the principal.

Under the Order, subcontracting was allowed provided the requirements for legitimate subcontracting were satisfied and the prohibition against labor-only contracting was observed. It is important to note that under this Order, there was no definition of legitimate subcontracting, and neither has the Labor Code defined it to date. Jurisprudence, however, supplied the requirements.

Department Order No. 3 also abolished the DOLE registry of subcontractors. The abolition, however, did not exempt subcontractors from the license or permit requirements administered by other regulatory agencies.

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[152] DOLE PRIMER ON CONTRACTING AND SUBCONTRACTING.

D. DEPARTMENT ORDER NO. 18

Dep't Order No. 18, issued by Secretary Patricia Santo Tomas on February 21, 2002, replaced Dep't Order No. 3. It aimed to reinforce the country's measures to surmount globalization's adverse effects. The new rules built upon the principles of the older Dep't Order No. 10 and reinforced the conditions for employing contractual workers, along with the responsibilities of principals, contractors and subcontractors.

Like its predecessors, the order reiterated the prohibition against labor-only contracting. It reassured contractual employees, at least on paper, of their entitlement to the rights and privileges enjoyed by regular employees under the law. These include the right to "safe and healthful working conditions; separation benefits; overtime, 13th month, and holiday pay, rest leaves and other standards; social security and welfare; self-organization, collective bargaining and peaceful action; and security of tenure."[153] The new Order sought to build upon industrial harmony by mandating the TIPCs to verify and monitor contracting activities, along with the regular reporting requirements, of those engaged in contracting and subcontracting.

The Order likewise expanded the prohibited forms of contracting or subcontracting by enumerating six prohibited activities:

> (1) Contracting out a job, work or service when not in good faith and not justified by the exigencies of the business, resulting in the termination of regular employees and reduction of work hours or reduction or splitting of the bargaining unit;
>
> (2) Contracting out to a "cabo" – a person, or group of persons, or labor group, in the guise of a labor organization, supplies workers to an employer, whether in the capacity of an agent of the employer or as an ostensible independent contractor;
>
> (3) Taking undue advantage of the economic situation or of a contractual employee's lack of bargaining strength or undermining his security of tenure or basic rights, or circumventing the provisions of regular employment;

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[153] DOLE Order No. 18 (2002).

(4) Contracting out of work through an in-house agency, such as a contractor or subcontractor owned, managed or controlled by the principal, and operating solely for that principal;

(5) Contracting out of work directly related to the business or operation of the principal, by reason of a strike or lock-out whether actual or imminent; and

(6) Contracting out of work being performed by union members when such will interfere with the employees' exercise of their rights to self-organization.[154]

The order's section 5 identifies the badges or indicia of labor-only contracting which create the presumption that a contractor is engaged in the prohibited practice.[155] These are lack of substantial capital, allowing contractual employees to do regular work, and a contractors' lack of control over the contractual workers.

Moreover, section 7 considers the contractor or subcontractor as the employer of the contractual employee "for the purposes of enforcing the

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[154] Jonathan Sale, *New Rules on Contracting and Subcontracting: Flexibility vs Job Security*, *at* http://www.dlsu.edu.ph/research/centers/cberd/pdf/bus_focus/Newrules.pdf..

[155] "*Prohibition against labor-only contracting.* – Labor-only contracting is hereby declared prohibited. For this purpose, labor-only contracting shall refer to an arrangement where the contractor or subcontractor merely recruits, supplies or places workers to perform a job, work or service for a principal, and any of the following elements are present:

"(i) The contractor or subcontractor does not have substantial capital or investment which relates to the job, work or service to be performed and the employees recruited, supplied or placed by such contractor or subcontractor are performing activities which are directly related to the main business of the principal; or

"(ii) The contractor does not exercise the right to control over the performance of the work of the contractual employee.

"The foregoing provisions shall be without prejudice to the application of Article 248 (c) of the Labor Code, as amended.

"'Substantial capital or investment' refers to capital stocks and subscribed capitalization in the case of corporations, tools, equipment, implements, machineries and work premises, actually and directly used by the contractor or subcontractor in the performance or completion of the job, work or service contracted out.

"The 'right to control' shall refer to the right reserved to the person for whom the services of the contractual workers are performed, to determine not only the end to be achieved, but also the manner and means to be used in reaching that end."

provisions of the Labor Code and other social legislation."[156] Here, the principal will be held solidarily liable with the contractor in the event of any violation of any Labor Code provision, specifically the failure to pay wages. When the situation arises, the principal is deemed the employer of the contractual employee where labor-only contracting exists, or where the contracting arrangement falls within the prohibitions provided under section 6. The principal is also liable if the contract with the subcontractor or subcontractor is preterminated for reasons not attributable to the latter.

Under section 19,[157] the principal shall be deemed the "direct employer" of the contractual employees and therefore liable, with the contractor or subcontractor, for "whatever monetary claims the contractual employees may have" under the following provisions:

(1) Section 5 (labor-only contracting);

(2) Section 6 (prohibitions);

(3) Section 8 (rights of contractual employees); and

(4) Section 16 (delisting).

The problem with the sanctions mentioned above is that they are inconsistent with each other, and worse, they contravene well-settled jurisprudence. While section 7 provides that labor-only contracting creates a

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[156] "*Existence of an employer-employee relationship.* – The contractor or subcontractor shall be considered the employer of the contractual employee for purposes of enforcing the provisions of the Labor Code and other social legislation. The principal, however, shall be solidarily liable with the contractor in the event of any violation of any provision of the Labor Code, including the failure to pay wages.

"The principal shall be deemed the employer of the contractual employee in any of the following cases as declared by a competent authority:

"(a) Where there is labor-only contracting; or

"(b) Where the contracting arrangement falls within the prohibitions provided in Section 6 (Prohibitions) hereof."

[157] "*Solidary liability.* – The principal shall be deemed as the direct employer of the contractual employees and therefore, solidarily liable with the contractor or subcontractor for whatever monetary claims the contractual employees may have against the former in the case of violations as provided for in Sections 5 (Labor-Only contracting), 6 (Prohibitions), 8 (Rights of Contractual Employees) and 16 (Delisting) of these Rules. In addition, the principal shall also be solidarily liable in case the contract between the principal and contractor or subcontractor is preterminated for reasons not attributable to the fault of the contractor or subcontractor."

direct-employer employee relationship between the principal employer and the workers for purposes of enforcing the provisions of the Labor Code and other social welfare legislation, section 19 delimits the liability of the principal employer and labor-only contractor to "whatever money claims the contractual employees may have" in case of a labor-only contracting violation. Under settled jurisprudence, labor-only contracting creates a direct employer-employee relationship between the workers of the labor-only contractor and the principal. Consequently, the principal assumes all the attendant obligations and liabilities imposed by law – not limited to the Labor Code and social legislation – on an employer vis-à-vis the workers and the public. Hence, third parties may sue the principal for torts committed by workers while performing their duties. Thus, sections 7 and 19 should be amended to conform to jurisprudence. The same should likewise apply to a violation of sections 6 and 8, as both provisions involve matters akin to the nature and effects of labor-only contracting.

Under Dep't Order No. 18, contractors and subcontractors are required to register in order to facilitate labor market information monitoring. Under the pertinent provisions, a contractor who fails to register is presumed to be engaged in labor-only contracting.

The creation of the presumption that an unregistered contractor is a labor-only contractor is in accord with jurisprudence. This sanction, taken together with the mandatory requisites supplied by jurisprudence and the law for the establishment of an independent contractor status, should make it harder for labor-only contractors to claim the status of an independent contractor.

Based on these regulations, one observes that, like the judiciary, the thrust of executive actions is towards the prohibition of labor-only contracting and the restriction of job contracting. The current regulation, Dep't Order No. 18, plainly reflects this trend in its requirement for registration, the inclusion of the "control test" as one of the conditions for determining the existence of labor-only contracting, the expansion of prohibited activities which would give rise to a finding of labor-only contracting, the omission of a listing of permissible areas of job-contracting, and the expansion of the liabilities of the principal to include pretermination of contracts and any violation of the expanded prohibited activities. The only problem with the regulation is its delimitation of a principal's liabilities in case some of its provisions are violated.

IV. CONCLUSIONS AND RECCOMENDATIONS

A. ENDING THE LABOR-MANAGEMENT DEBATE

For more than two decades, labor and management have been at loggerheads over labor-only contracting. If the labor leasing agencies and employers could have their way, the labor market, including the subcontracting of work and the utilization of the services of leasing agencies should be liberalized. Employers and labor contracting agencies argue that labor contracting will help promote greater economic efficiency and competitiveness leading to increased job opportunities. On the other hand, trade unions of various ideological and political persuasions are united in denouncing the practice, asserting that labor-only contracting is merely an employer's instrument to circumvent labor laws, exploit workers, erode security of tenure, and subvert unionism. Lately, they have been demanding that the practice be criminalized.[158]

1. Management side

In a position paper[159] submitted to the House Committee on Labor and Employment, the Employers Confederation of the Philippines called on Congress to break the vicious cycle of poverty, chronic unemployment and erratic and sluggish growth of the economy by promoting employment generation and expansion through the liberalization of job contracting activities. The paper asserts that liberalizing job contracting would create a friendly environment for investment, business creation and expansion, and the generation of protective employment.

Restricting job contracting, on the other hand, would make it difficult for employers to survive in a highly competitive market, and this will only bring disaster to the economy and to employment. It emphasized that prohibiting job contracting runs counter to changes in the labor market brought about by globalization and competition. It maintained that job contracting is not only allowed in article 106 of the Labor Code, but is premised on two constitutional rights: the freedom to contract and the right to property. It then argued that the legislative proposal to make employers the direct employers of contractors' workers performing usually necessary or desirable activities to the employers' usual trade or business is not only a

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[158] Ofreneo, *supra* note 18.

[159] Position Paper of the Employers Confederation of the Philippines on House Bill Nos. 224, 720 and 1009 (Feb. 12, 2002) (on file with the authors).

blatant violation of article 106, but an infringement on employer's constitutional right to property.

Professor Cezar Azucena takes a more radical view. He called for the abolition of the distinction between job contracting and labor-only contracting, and argued that retaining the distinction between the two is both unwise and outdated on four grounds. First, contracting out not only multiplies and disperses job opportunities, it also promotes skills formation. Second, the dividing line between job contracting and labor-only contracting is ill defined, confusing and overlapping, and the law and the regulations cause friction among workers, employers and unions. Third, the presence of the prohibition breeds corruption. In this country where corruption is as invasive and tenacious as poverty, every prohibition by law is an occasion for corruption. And fourth, contracting is specialization, hence an efficient and economical way of doing things and services. Contracting is practiced worldwide because it is a necessary concomitant of globalized free trade.[160]

He further maintained that relaxing the law on labor contracting or even writing it off does not mean implicit condonation of exploitation. On the contrary, it means making the contractors legitimate businessmen who are subject to all applicable laws including those on social security coverage, security of tenure, minimum wage, and capitalization. It also means forcing contractors to render quality job, work or service to retain its clientele.[161]

Professor Rene Ofreneo shares the same view. He argues that adopting a total prohibition approach on labor-only contracting is not feasible as there are economic aspects of labor contracting which are difficult to counter and label as anti-labor, such as maintaining a pool of trained workers to be supplied in an instant when needed by a firm during peak seasons. He posits that the proposal to ban labor-only contracting will not curb labor abuses associated with fly-by-night manpower agencies and exploitative labor-contracting practices because such will only drive these agencies deeper underground. He instead proposed the licensing of manpower agencies, arguing this will make it easier DOLE and other agencies to monitor their activities to weed out the bad from the good, and to enforce some kind of a Code of Behavior which leasing agencies have to observe.[162]

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[160] Azucena, *supra* note 37, ¶¶ 25-28.
[161] *Id.*, ¶ 29.
[162] Ofreneo, *supra* note 18.

3. Labor side

Contingent employment such as labor-only contracting is outside the scope of industrial relations and protective labor legislation, unlike regular employment, which is fully protected by law. As a result, contingent employees are prone to abuse and exploitation. Exploitative and abusive practices are widespread among firms which engage in contingent employment. Moreover, such type of employment has serious implications on employment security in the formal sector. First, it leads to a general reduction of the regular workforce and therefore, of the number of workers with regular tenure. Second, the widespread utilization of labor flexibility measures vastly erodes the bargaining power and overall employment security of the regular workers.[163] Lastly labor-only contracting poses a triple threat to labor: a threat to the job security of regular workers, a threat to the security of the union, and a threat to the labor standards enjoyed by the regular workers.

The Supreme Court has taken judicial notice of the fact that labor-only contracting has been resorted to by unscrupulous employers to exploit labor, circumvent the provisions of the Labor Code and to escape the just claims of their workers and other employees.[164] The Court noted that employers resort to such schemes in order to deny the existence of an employer-employee relationship, which effectively withholds from the workers benefits accorded to regular employees, such as security of tenure, the right to join unions, and the right to engage in collective bargaining. This weakens the latter's bargaining unit because they cannot recruit workers who should have been regular employees.

In several cases, the Supreme Court expressed its indignation over the various forms in which businessmen, with the aid of lawyers, disguise labor-only contracting arrangements in order to avoid bringing about an employer-employee relationship which spawns obligations connected with workmen's compensation, social security, Medicare, minimum wage, termination pay and unionism.[165] The Court further deplored the fact that

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[163] Rene Ofreneo & Nicolas Barriatos, Employment Security and Labor Flexibility in the Philippines (1991). (This paper was contributed to the International Comparative Research Project on Labor Market Flexibility and Employment Security of the International Labor Organization).

[164] Jang Lim v. Nat'l Lab. Rel. Comm'n, G.R. No. 124630, 303 SCRA 432, 447, Feb. 19, 1999.

[165] Mafinco Trading Corp. v. Ople, G.R. 37790, 70 SCRA 139, 159, Mar. 25, 1976.

without a law prohibiting labor-only contracting to protect the rights of labor, poor workers will always be at the mercy of the employer.[166]

A similar view on labor-only contracting is presented by a number of labor scholars. According to Professor Francis Raday, labor-only contracting effectively severs the employer-employee relationship between workers and principal employers, on whose premises they work and for whom they provide needed labor inputs. This allows employers to utilize labor while avoiding many of the specific social, legal, and contractual obligations that have increasingly attached to employer status. This likewise desocializes the workplace and creates an entire population of disenfranchised workers who have no voice in workplace democracy and processes, creating an insider-outsider division, as well as disadvantaging the leased employee as an outsider and undermines union power by fragmenting the internal labor market. Moreover, it has an inherent potential to expose leased workers to exploitation and an innate propensity for undercutting in-house standards for core employees and undermining the collective bargaining power of trade unions.[167]

In the same vein, Professor George Gonos, asserts that the arrangement allows the use of labor while avoiding the consequent responsibilities for workers.[168]

Professor Leah Vosko maintains that labor-only contracting schemes constitute an effective means of "effectively excluding" many workers from union representation, since such arrangements posed serious difficulties for modes of trade union organizing. She pointed out that these schemes played an important role in the drift toward lower wages and greater employment insecurity for a significant portion of the American workforce.[169]

B. RECOMMENDATIONS

Based on the foregoing, the absolute prohibition of the practice is imperative to put an end to labor's woes. The State must invoke its police power to end this exploitative practice.

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[166] Ecal v. Nat'l Lab. Rel. Comm'n, G.R. No. 92777, 195 SCRA 224, 228, Mar. 13. 1991.

[167] Raday, *supra* note 20, at 418.

[168] Gonos, *supra* note 1, at 88.

[169] Vosko, *supra* note 24, at 47-48.

While the Constitution protects the rights of employers to a reasonable return on their investments and to expansion and growth,[170] the primacy of human dignity over things is recognized as a value of paramount importance. As aptly stated by Commissioner Bacani,[171] the Constitutional policy[172] affirming the "primacy of labor" over the non-human factors of production is but an assertion of the supremacy of human dignity over things. Prohibiting the practice would thus affirm the supremacy of human dignity over profits. Moreover, allowing the practice to continue would be tantamount to an abdication of the State's primary duty to afford full protection to labor and to guarantee basic labor rights such as the right to just and humane terms and conditions of employment, right to self-organization, right to collective bargaining and right to security of tenure.[173]

The prohibition on labor-only contracting must not, however, mean that other forms of labor contracting are prohibited. Labor contracting is allowed where the conditions for the existence of labor-only contracting are absent, or conversely, where the conditions for legitimate job contracting are present. These clear-cut distinctions are best drawn out by a careful perusal of regulations and jurisprudence. Distinctly drawing the lines would enable employers, contractors, and regulatory bodies to easily identify what is permissible and impermissible job contracting.

Regulating the labor-only contractors is not advisable. Efforts to regulate the contractors will rarely be sufficient because the contractors are

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[170] CONST. art XIII, § 3.

[171] RECORD OF THE CONSTITUTIONAL CONVENTION 891 (1972) (Session on Nov. 24, 1972). "It is really an assertion of the supremacy of human dignity over things.

In the process of production, labor is always a primary and efficient cause, while capital remains a mere instrumental cost. We will notice that all the means by which a person appropriates natural resources and transforms them in accordance with his need are the result of the historical heritage of human labor. Besides, it is clear that every person sharing in the production process is the real efficient subject, while the collection of instruments, no matter how perfect they are, is only a mere instrument subordinate to human labor."

[172] CONST. art. II, § 18: "The State affirms labor as a primary social economic force. It shall protect the rights of workers and promote their welfare."

[173] Art. XIII, § 3. "The State shall afford full protection to labor... and promote full employment and equality of employment opportunities for all.

"It shall guarantee the rights of workers to self-organization, collective bargaining and negotiations, and peaceful, concerted activities, including the right to strike in accordance with law. They shall be entitled to security of tenure, humane conditions of work, and a living wage. They shall also participate in policy and decision-making processes affecting their rights and benefits as may be provided by law."

too numerous, the economic pressures on them to compete by undermining labor standards too intense, and new subcontractors will always replace ones that are put out of business.[174] Unless an army of labor inspectors is employed, it will be impossible to ferret out the thousands of labor-only contractors that have mushroomed throughout the country.

Experience has already shown that the regulations issued by the Secretary of Labor are ineffective in curbing the proliferation of the practice. In fact, studies on industrial establishments resorting to labor contracting arrangements show that labor regulations apparently had very little influence in the establishments' use such contractual schemes to cut on costs.[175] The regulations are likewise ineffective in protecting workers from the exploitative effects of labor-only contracting.

The primary focus of the sanctions against labor-only contracting should be directed towards the employer, instead of the labor-only contractor. Any strategy to ameliorate the insidious effects of labor-only contracting must focus on the entities that have the economic power to change the system: the companies that retain the labor-only contractors. Laws and regulations should place responsibility for wages, benefits, working conditions and all other obligations and liabilities attendant to an employer-employee relationship on the companies that contract out. Emphasizing the responsibility of the company that contracts out, rather than that of the subcontractor, will maximize the impact of the limited resources available to prevent substandard employment practices.

This approach also benefits those employers that prefer to treat their workers well. Companies deserve protection against unfair competition by unscrupulous employers that seek to undermine labor standards and lower labor costs by resorting to labor contractors. Thus, the provision holding the labor-only contractor solidarily liable with the principal employer should be amended in order to hold the principal employer solely liable to the workers. This is consistent with the fact that labor-only contracting creates a direct employer-employee relationship between the workers and the principal employer, and not between the workers and both the labor-only contractor and the principal employer. This is likewise in harmony with the rules on agency which hold the principal solely liable for acts of the agent done within the scope of his authority. As the agent of the

[174] Goldstein, *supra* note 8, at 1161-1163.

[175] JAMES WINDELL & GUY STANDING, ILO WORKING PAPER NO. 59, EXTERNAL LABOUR FLEXIBILITY IN FILIPINO INDUSTRY (1992).

principal employer, the labor-only contractor cannot be said to have acted outside the scope of its authority when it supplies workers to its principal, as such is obviously the main reason why the latter contracted with him. Moreover, the liability of the principal employer should not be delimited to monetary claims of workers as prescribed by section 19 of Dep't Order No. 18.[176] This is contrary to jurisprudence and the law. All the attendant liabilities and obligations of an employer vis-à-vis its workers and the public should automatically attach.

There is a pressing need to implement these proposals if the primacy of labor as enshrined in our fundamental law would be upheld. If the insidious effects of labor-only contracting can no longer be addressed by piecemeal executive actions and judicial ambivalence, then it is time to attack the problem from a different perspective. It is time. Push has come to shove.

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[176] "*Solidary liability.* - The principal shall be deemed as the direct employer of the contractual employees and therefore, solidarily liable with the contractor or subcontractor for whatever monetary claims the contractual employees may have against the former."

ANNEX A: PROPOSALS FOR THE LEGISLATURE

Article 106 should read as follows:

"Article 106. Contractor or subcontractor. — Whenever an employer enters into a contract with another person for the performance of the former's work, the employees of the contractor and of the latter's subcontractor, if any, shall be paid in accordance with the provisions of this Code.

THERE IS PERMISSIBLE JOB CONTRACTING WHERE A PRINCIPAL AGREES TO PUT OUT OR FARM OUT WITH A CONTRACTOR OR SUBCONTRACTOR THE PERFORMANCE OR COMPLETION OF A SPECIFIC JOB, WORK OR SERVICE WITHIN A DEFINITE OR PREDETERMINED PERIOD, AND THE FOLLOWING CONDITIONS ARE PRESENT:

> A) THE CONTRACTOR CARRIES ON AN INDEPENDENT BUSINESS AND UNDERTAKES THE CONTRACT WORK ON HIS OWN ACCOUNT UNDER HIS OWN RESPONSIBILITY ACCORDING TO HIS OWN MANNER AND METHOD, FREE FROM THE CONTROL AND DIRECTION OF HIS EMPLOYER OR PRINCIPAL IN ALL MATTERS CONNECTED WITH THE PERFORMANCE OF THE WORK, EXCEPT AS TO THE RESULTS THEREOF; AND
>
> B) THE CONTRACTOR HAS SUBSTANTIAL CAPITAL OR INVESTMENT IN THE FORM OF TOOLS, EQUIPMENT, MACHINERIES, WORK PREMISES AND OTHER MATERIALS WHICH ARE ACTUALLY AND DIRECTLY USED IN THE PERFORMANCE OF THE WORK CONTRACTED OUT.

"SPECIFIC JOB" SHALL MEAN A SPECIAL TYPE OF VENTURE OR PROJECT, THE DURATION OF WHICH IS COTERMINOUS WITH THE COMPLETION OF THE PROJECT. IT SHALL NOT INCLUDE ACTIVITIES WHICH ARE DIRECTLY RELATED OR USUALLY NECESSARY OR DESIRABLE TO THE MAIN BUSINESS OR TRADE OF THE PRINCIPAL.

In the event that the contractor or subcontractor fails to pay the wages of his employees in accordance with this Code, the employer shall be jointly and severally liable with his contractor or subcontractor to such employees to the extent of the work performed under the contract, in the same manner and extent that he is liable to employees directly employed by him.

> ~~The Secretary of Labor may, by appropriate regulations, restrict or prohibit the contracting out of labor to protect the rights of workers established under this Code. In so prohibiting or restricting, he may make appropriate distinctions between labor-only contracting and job contracting as well as differentiations within these types of contracting and determine who among the parties involved shall be considered the employer for purposes of this Code, to prevent any violation or circumvention of any provision of this Code.~~

THE SECRETARY OF LABOR SHALL REGULATE PERMISSIBLE JOB CONTRACTING TO PROTECT THE CONSTITUTIONALLY GUARANTEED RIGHTS OF WORKERS.

LABOR-ONLY CONTRACTING IS HEREBY PROHIBITED. There is "labor-only" contracting IF THE CONTRACTOR OR SUBCONTRACTOR MERELY RECRUITS, SUPPLIES OR PLACES WORKERS TO PERFORM A JOB, WORK OR SERVICE FOR A PRINCIPAL, AND ANY OF THE FOLLOWING ELEMENTS ARE PRESENT:

> 1) THE CONTRACTOR DOES NOT HAVE SUBSTANTIAL CAPITAL OR INVESTMENT IN THE FORM OF TOOLS, EQUIPMENT, MACHINERIES, WORK PREMISES AND OTHER MATERIALS WHICH ARE DIRECTLY AND ACTUALLY USED IN THE PERFORMANCE OF THE WORK CONTRACTED OUT;
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> 2) THE CONTRACTOR DOES NOT CARRY ON AN INDEPENDENT BUSINESS;
>
> 3) THE CONTRACTOR DOES NOT UNDERTAKE THE WORK ON HIS OWN ACCOUNT UNDER HIS OWN RESPONSIBILITY ACCORDING TO HIS OWN MANNER AND METHOD;

4) THE PRINCIPAL EMPLOYER EXERCISES CONTROL AND DIRECTION OVER ALL MATTERS CONNECTED WITH THE PERFORMANCE OF THE WORK, INCLUDING THE RESULTS THEREOF;

5) THE CONTRACTOR DOES NOT EXERCISE THE RIGHT OF CONTROL OVER THE PERFORMANCE OF THE WORK OF THE CONTRACTUAL EMPLOYEE; OR

6) THE EMPLOYEES RECRUITED, SUPPLIED OR PLACED BY SUCH CONTRACTOR OR SUBCONTRACTOR ARE PERFORMING ACTIVITIES WHICH ARE DIRECTLY RELATED TO THE MAIN BUSINESS OF THE PRINCIPAL." ~~In such cases, the person or intermediary shall be considered merely as an agent of the employer who shall be responsible to the workers in the same manner and extent as if the latter were directly employed by him."~~

IN DETERMINING WHETHER THE TASK OR ACTIVITY PERFORMED BY EMPLOYEES ARE PLACED OR RECRUITED IS RELATED TO OR USUALLY NECESSARY OR DESIRABLE IN THE USUAL BUSINESS OR TRADE OF THE PRINCIPAL EMPLOYER, THE NATURE OF THE ACTIVITIES PERFORMED AND THEIR RELATION TO THE SCHEME OF THE PARTICULAR BUSINESS OR TRADE IN ITS ENTIRETY SHALL BE THE MAJOR CRITERION.

THE SECRETARY OF LABOR MAY, BY APPROPRIATE REGULATIONS, PROVIDE FOR PRIMA FACIE PRESUMPTIONS OF LABOR-ONLY CONTRACTING BASED ON THE IMMEDIATELY PRECEDING ELEMENTS.

THE EFFECTS OF LABOR-ONLY CONTRACTING SHALL INCLUDE BUT NOT BE LIMITED TO THE FOLLOWING:

1) THE LABOR-ONLY CONTRACTOR SHALL BE TREATED AS THE AGENT OF THE PRINCIPAL AND ALL THE REPRESENTATIONS MADE BY FORMER TO THE EMPLOYEES SHALL BIND THE PRINCIPAL;

2) THE PRINCIPAL SHALL BECOME THE EMPLOYER AS IF IT DIRECTLY EMPLOYED THE WORKERS ENGAGED TO UNDERTAKE

THE CONTRACTED OUT JOB OR SERVICE. IT SHALL ASSUME ALL THE ATTENDANT LIABILITIES AND OBLIGATIONS OF AN EMPLOYER AS PROVIDED BY LABOR LAWS, SOCIAL LEGISLATION AND OTHER LAWS;

3) THE PRINCIPAL SHALL BE SOLELY TREATED AS THE EMPLOYER;

4) THE WORKERS SHALL BECOME EMPLOYEES OF THE PRINCIPAL, SUBJECT TO THE CLASSIFICATIONS OF EMPLOYEES UNDER ARTICLE 280 OF THE LABOR CODE;

5) THE PRINCIPAL, IN A CIVIL SUIT FOR DAMAGES INSTITUTED BY AN INJURED PERSON, MAY BE HELD LIABLE FOR ANY NEGLIGENT ACTS OF THE WORKERS OF THE LABOR-ONLY CONTRACTOR;

6) IF THE LABOR-ONLY CONTRACTING ACTIVITY IS UNDERTAKEN BY A LEGITIMATE LABOR ORGANIZATION, A PETITION FOR CANCELLATION OF UNION REGISTRATION MAY BE FILED AGAINST IT;

7) THE PRINCIPAL SHALL BE HELD LIABLE FOR UNFAIR LABOR PRACTICES IF IT CONTRACTS OUT THE SERVICES OR FUNCTIONS BEING PERFORMED BY THE LABOR-ONLY CONTRACTOR'S WORKERS WHO ARE UNION MEMBERS, WHEN SUCH WILL INTERFERE WITH, RESTRAIN OR COERCE THE WORKERS IN THE EXERCISE OF THEIR RIGHTS TO SELF-ORGANIZATION;

8) THE PRINCIPAL MUST RECOGNIZE AND RESPECT THE FOLLOWING RIGHTS OF THE LABOR-ONLY CONTRACTOR'S WORKERS: RIGHT TO SELF-ORGANIZATION; RIGHT TO SECURITY OF TENURE, AND RIGHT TO COLLECTIVE BARGAINING. ANY VIOLATION

THEREOF WOULD MAKE IT DIRECTLY LIABLE TO THE WORKERS; AND

9) OTHER EFFECTS WHICH THE SECRETARY OF LABOR MAY DETERMINE IN ORDER TO PROTECT THE RIGHTS OF WORKERS."

A new article should be added, which should read as follows:

"ARTICLE 106-A. IN DETERMINING WHETHER A LABOR-ONLY CONTRACTING OR A LEGITIMATE JOB CONTRACTING ARRANGEMENT EXISTS, THE FOLLOWING CONDITIONS SHOULD BE TAKEN INTO ACCOUNT:

1) WHETHER THE CONTRACTOR HAS SUBSTANTIAL CAPITALIZATION OR INVESTMENT IN THE FORM OF TOOLS, EQUIPMENT, MACHINERIES AND WORK PREMISES, AMONG OTHERS, WHICH ARE DIRECTLY AND ACTUALLY USED IN THE PERFORMANCE OF THE SERVICES CONTRACTED OUT;

2) WHETHER THE CONTRACTOR IS CARRYING ON AN INDEPENDENT BUSINESS;

3) THE NATURE AND EXTENT OF THE WORK;

4) THE SKILL REQUIRED;

5) THE TERM AND DURATION OF THE RELATIONSHIP;

6) THE RIGHT TO ASSIGN THE PERFORMANCE OF SPECIFIED PIECES OF WORK;

7) THE POWER OF THE EMPLOYER WITH RESPECT TO THE HIRING, FIRING AND

PAYMENT OF THE WORKERS OF THE CONTRACTOR;

8) THE CONTROL OF THE PREMISES;

9) THE DUTY TO SUPPLY PREMISES, TOOLS, APPLIANCES, MATERIALS AND LABOR;

10) THE MODE, MANNER AND TERMS OF PAYMENT; AND

11) THE CONTROL AND SUPERVISION OF THE WORKERS; WHICH IS THE MOST DETERMINATIVE OF ALL.

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ANNEX B: PROPOSALS FOR THE EXECUTIVE

Section __. *Prima Facie Presumptions Of Labor-Only Contracting.* Any of the following circumstances shall give rise to a presumption of labor-only contracting:

1. The subcontractor or contractor does not have a license to engage in subcontracting or independent contracting;

2. The workers use the principal employer's tools and equipment in their work;

3. The workers supplied are performing activities, which are directly related or usually necessary or desirable to the principal business of the employer;

4. The contractor's workers are continuously assigned to a single establishment and never transferred to any other establishment;

5. Workers are confined to the work premises at the beginning of the working day, all throughout the performance of their duties for the day, until shop closing time;

6. The principal employer exercises the right to dismiss and discipline the workers;

7. The labor contractor hires workers as its employees in anticipation of, and for the very purpose of making possible the assignment of the workers to the principal employer;

8. The workers were already working with the principal employer before they were hired by the job contractor and they are regularly assigned to perform the same jobs in the premises of the principal employer;

9. The principal employer hires the workers and then places them under their respective subcontractors;

10. The principal employer does not remit a lump sum to the labor contractor as payment for the workers' services but merely gives him a fixed fee or commission;

11. The principal employer assumes the responsibility of paying for the mandated overtime, holiday, rest day pays of the workers including the employer's share of the SSS and Medicare contributions, the 13th month pay, incentive leave pay and maternity benefits;

12. The workers are made liable directly to the principal employer for any loss or damage caused by former, with the latter directly deducting such amounts for loss or damage from their salaries;

13. The right to control and supervise the means and methods by which the work shall be effected is reserved or actually exercised by the principal employer solely or jointly with the contractor;

14. Workers are required by the principal employer not only to keep regular working hours, but to render overtime service as well when such is necessitated either by the volume or immediacy of the work; and

15. The principal employer requires the labor-only contractor to undertake substantial capitalization and investments as a condition for the execution of a long-term service contract that would enable the latter to recoup its investments.

Section __. *Impermissible Areas of Job Contracting*. The following activities are deemed directly related to the principal business to which they correspond to, and may not be validly contracted out to independent contractors:

ACTIVITIES	PRINCIPAL BUSINESS
1. Milling, piling and bundling of log ends or sawn lumber; and clearing and hauling of firewood or waste firewood	Production and manufacture of plywood and veneer
2. Work of a sales representative, e.g. booking sales orders and collecting payments.	Food manufacturing and sales
3. Merchandising, promotion or sale of food products, except where the contractor has complied with all the requisites of an independent contractor	Manufacturing and distribution of food products
4. Buffing, quality control, assembler, and lathe machine operation	Steel and metal fabrication of machine spare parts
5. Construction of power energy facilities	Power generation
6. Work of merchandisers, cashiers, baggers, check-out personnel, sales ladies, and warehousemen	Operation of a supermarket
7. Work of film and shooting crew members such as loading, unloading and arranging of movie equipment in the shooting area as instructed by the cameramen, returning the equipment to Viva Films' warehouse, and assisting in the "fixing" of the lighting system	Making, distributing and exhibiting movies
8. Carpentry and plumbing work including maintaining, renovating, remodeling and repairing the school building and other facilities	Operation of educational institution
9.Removing "bulgings" (damaged goods) from dilapidated cartons, replacing damaged goods and re-pasting the carton thereof, disposing damaged goods or returning goods from the principal employer's warehouse to avoid bad odors, cleaning leftovers of leaking tetra-pack by mopping or washing the contaminated premises	Production of tetra-pack juices and drinks.
10. Sorting out lumber materials whether wet or fresh kiln as to sizes, carrying them from the stockpile to the dryer where they are loaded for drying, and unloading them after they have dried	Operation of a sawmill
11. Operating Xerox or copier machines	Selling and leasing copier machines
12. Messengerial work— the delivery of documents to designated persons whether within or without the bank premises	Operation of a bank

13. Work of "cargadores" who load, unload and pile sacks of palay from the warehouse to the cargo truck	Operation of a rice mill
14. Work of carpenters, welders, and electricians if they have been continuously working for more than one year	Air transportation
15. Janitorial services	Manufacture of steel products such as LPG cylinders and drums
16. Brewery plant-maintenance, janitorial, utility and relative services	Beer production and distribution

Section ___ *Permissible Areas of Job Contracting.* The following activities are deemed incidental to the principal business to which they correspond to, and may therefore be validly contracted out to a contractor as long as said contractor has satisfied all the requirements of an independent contractor:

SERVICES	PRINCIPAL BUSINESS
1) Services of bottling crew and utility workers	Bottling, distribution and sale of soft drink products
2) Services of radio/telex operators	Operation of a bank
3) Promotions and merchandising activities	Food manufacturing or distributing
4) Janitorial and yard maintenance services	Manufacturing consumer paper products and cigarette paper
5) Janitorial services	Manufacturing polyester fiber
6) Construction of an annex building	Flour and feeds manufacturing
7) Services of collecting agents	Distribution and sale of sewing machines
8)Stevedoring and arrastre services	Shipping business
9) Repair, maintenance, and installation services on pipelines and other structures of a geothermal plant	Exploration and exploitation of geothermal resources

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