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Federal Labor Law Reforms regarding "Subcontracting"

Introduction

On November 30, 2012 a series of Federal Labor Law reforms were published in the Official Federal Gazette. The labor reform, which has been promoted as a tool for increasing the productivity of the country, was generally well received by the business and labor community, since it introduced novel legal concepts (*e.g.*, new forms of hiring), and amended certain provisions that created incentives for prolonging labor lawsuits unnecessarily (*e.g.*, limitation on accrued salary).

One of the aspects that has been controversial, however, is regarding subcontracting. Many abuses have been committed in recent years through subcontracting, attempting to eliminate or reduce labor rights (principally benefits) and to entirely or partially evade the payment of contributions to social security. In order to combat these abuses, the Congress of the Union introduced a series of limitations on subcontracting; however, they have caused concern among the business and legal sector because the regulation introduced is not completely clear or specific regarding how it should be applied. This brief note describes the reforms introduced regarding subcontracting and the effects such regulation may have on companies and their operations in Mexico.

It should be emphasized that the reform is not provide much detail with respect to subcontracting and its consequences. Although subcontracting is regulated generally and it is provided that in some cases the contracting company and beneficiary of the services will be considered the employer, the articles related to this topic will have to be interpreted and applied by the judicial authorities (conciliation and arbitration boards and federal courts) and administrative authorities, and therefore any analysis done at this time cannot be considered definitive, but rather the application of the reform to concrete cases will have to be closely monitored.

The Subcontracting Regime

The relevant articles of the reform (articles 15-A, 15-B, 15-C and 15-D) define the subcontracting regime and indicate certain requirements that such regime must meet, in the understanding that if any of such requirements are not met, the workers under the subcontracting regime will be considered employees of the contracting company and beneficiary of the services.

Therefore, first it is necessary to analyze what the reform understands for subcontracting, in order to then be able to determine whether the above mentioned requirements must be complied with.

Mistakenly in our opinion, subcontracting has been generally associated with outsourcing and even with all forms of subcontracting or provision of services and works between companies of the same business group. It should be taken into account that there are different types of outsourcing, according to which the company providing the services is limited to providing exclusively personnel services (*Human Resources Outsourcing* or HRO), or it is responsible for satisfying the

information technology needs of a client (*Information Technology Outsourcing* or ITO) or for one or more operational processes of the client (*Business Process Outsourcing* or BPO). As we will see, the subcontracting regime refers specifically to the provision of personnel services, in which a company simply provides human resources who act under the supervision of the client. In this regard, the subcontracting regime applies to a situation in which the two elements of a work relationship (provision of personal subordinated work and economic remuneration) are divided, such that a worker provides his subordinated services to a person other than the one that pays his salary and benefits.

The reform defines the subcontracting regime as the regime through which *an employer called contractor executes works or provides services with its workers who are dependent on it, to a beneficiary, individual or entity, which establishes the work of the contractor and supervises it in the performance of the services or execution of the works contracted.*

According to this definition, for a services relationship to be considered as subcontracting, there must be three elements present: (i) that the contractor executes works or provides services with workers dependent on it, i.e., that they receive their salary from the contractor; (ii) that the beneficiary establishes the work of the contractor and (iii) that the beneficiary supervises the performance of the services or execution of the contracted work. If any of these elements are missing, subcontracting does not exist strictly speaking.

Several comments can be made regarding this definition. First of all, it should be mentioned that the supply of goods, including when they are manufactured by companies of the same group, does not constitute a regime of *outsourcing* or subcontracting strictly speaking. Therefore, those corporate organizational schemes in which one company of the group manufactures products for their sale to other companies of the same group (whether for their incorporation into the productive process or for their sale), are not subject to this regime. Similarly, for example, the maquila operations in which manufacturing services are provided with personnel directed and supervised by the maquiladora company will not fall under the definition of subcontracting.

In conclusion, and as a general recommendation, it will be necessary to analyze case by case the commercial relationship between the services company and the beneficiary of the services in order to determine if a subcontracting regime exists and, in any case, carefully and exhaustively review the contracts that govern the relationship between the companies in order to determine whether the relationship would be considered subcontracting.

Subcontracting and Employer Liability

When a subcontracting regime exists, the law establishes three requirements that must be met, in the understanding that if any of them are not met, the company benefiting from the services will be considered the employer for all legal effects, including Social Security obligations. The work under the subcontracting regime:

a) Cannot cover all of the activities, the same or similar in their entirety, that are performed in the work place.

b) Must be justified by its specialized nature.

c) May not include work the same as or similar to the work done by the rest of the workers hired by the beneficiary.

In labor matters there are three types of liabilities: (i) joint and several liability; (ii) secondary liability; and (iii) employer liability.

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The concepts of "joint and several liability" and "secondary liability", currently established in the Federal Labor Law and in the Social Security Law (as of the reform of article 15-A of the SSL of July 2009), respectively, were already provided for, both in the concept of the beneficiaries of the services provided and in the intermediaries. Thus, the Federal Labor Law indicates that both the beneficiary company and the intermediary would be considered jointly liable for the employment of the worker, provided that the true employer or intermediary company does not have sufficient resources of its own to meet its labor obligations. In addition, the Social Security Law indicates that in the case of the provision of personnel services, the beneficiary of the services will be liable when the true employer fails to meet its obligations, provided the Mexican Social Security Institute (IMSS) has notified the true employer in advance of the corresponding requirement and the latter has not responded.

In this regard, with this reform the companies benefitting from the subcontracted services will become jointly and severally and/or secondarily liable being considered the employer when the requirements indicated in article 15-A of the Federal Labor Law are not met.

Now, since the Federal Labor Law was issued, there has always been the risk that, in some cases, a worker contracted by a personnel services company would claim that his true employer is the beneficiary of such services, alleging precisely that the subordination relationship existed with the beneficiary of the services and not with the provider of the services, and recent court decisions in this regard seem to show a trend in this direction. The labor reform regarding subcontracting recognizes this situation and in this respect does not represent an additional or totally new risk. From another perspective, the reform is positive in that it provides legal certainty to the subcontracting schemes, since it must be understood that if a subcontracting regime meets the requirements established in the Federal Labor Law, the service provider will be considered the employer for all legal effects.

As we indicated previously, the requirements for the beneficiary of the services not to be considered the employer and therefore to be released from any liability with regard to the workers of the contractor (outsourcing company) are the following:

1) *The work provided may not cover all the activities, the same or similar in their entirety, that are performed in the work place.* In other words, it is not allowed for the company providing the personnel to be responsible for all the personnel assigned to the beneficiary company.

2) *The work must be justified according to its specialized nature.* The law does not indicate what level of specialty there must be and it is foreseeable that this concept will be better defined by judicial decision. In general terms, however, this requirement is met when there is a degree of specialization that justifies hiring under this regime.

3) *It cannot cover work the same as or similar to the work that the rest of the workers of the beneficiary are doing.*

Recommendations

Considering all of the above, we recommend to our clients and friends that they analyze their particular situation, from the operational and contractual point of view, in order to determine if there is any services relationship that could be considered as "subcontracting" for purposes of the Federal Labor Law and, if so, to determine if the requirements are met for the beneficiary company to be considered the employer. Once this analysis is done, it can be determined whether or not it will

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be necessary or advisable to change the form of contracting and whether changes should be made to the contractual and/or the operating scheme in order to comply with the legal requirements.

In any case, the most important thing is to consider that an analysis should be done of the specific situation of each company and that it will only be possible (and ethical) to make specific recommendations after an individual analysis.

We would be glad to help you with any analysis or study of the needs of your company.

If you require additional information please contact our experts:

Javier Lizardi, Partner: jlizardi@vwys.com.mx
Luis Burgueño, Partner: lburgueno@vwys.com.mx
Rodolfo Trampe, Associate: rtrampe@vwys.com.mx

Sincerely,

Von Wobeser & Sierra

Mexico City, January, 2013.