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Service Contracts: criteria for 'genuine' contracts

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Focus on service contracts

The increasingly common use of outsourcing has resulted in the Italian labour courts paying closer attention to the provisions of service contracts and, in particular, to the criteria for identifying such a contract as genuine – that is, consistent with Italian employment legislation (most significantly, Legislative Decree 276/2003).

In practice, not all service contracts are 'genuine' in this sense because their use by companies may belie a situation of sole labour supply. Under non-genuine contracts, a contractor supplies its employees to a client, thereby creating a situation of 'fictitious interposition' in which employees are formally employed by one party, but effectively carry out their duties in favour of another.

Under such contracts the client is the real (but not the formal) employer of the contractor's employees and reaps the benefit in terms of labour costs. Limiting the number of individuals that it formally employs may also allow the client to circumvent certain laws that apply only to employers over a certain size – for example, the law on dismissal provides for the reinstatement of an unfairly dismissed employee only if the employer has more than 15 employees.

Contracts that place considerable demands on workers in terms of employment performance – normally termed 'labour- intensive contracts – have been the object of particular labour court scrutiny because they do not comply with Italian labour law if they entail the permanent engagement of the contractor's employees within the client's company structure. In respect of such contracts, the labour courts are adapting to the principles set out by the Supreme Court, which has adopted a different approach since Legislative Decree 276/2003 came into effect. Previously, under the provisions of Law 1369/1960, labour-intensive contracts were always considered unlawful.

In the reform of Italian legislation on the job market in 2003, service contracts were acknowledged to be a legitimate means of business change, rather than hazardous strategy, provided that they are used appropriately.

Recent labour court decision and identification of genuine contracts

A decision issued by the Rome Labour Court on January 9 2012 stated that "in principle, labour-intensive contracts - that is, contracts in which the supply of tools and money is marginal compared to the supply of labour performance - are admissible". This ruling confirmed a new trend in contractual provisions and in case law on contractual matters. The court specified that in this case the contractor's legal requirement to organise the necessary means may also be demonstrated when "the authority to direct and organise the contractor's employees is exercised solely by the contractor, without interference from the client".

The decision is in line with other labour court and Supreme Court decisions on contractual matters. In providing further criteria for identifying genuine contracts, this decisional practice has expanded on the legal requirements (indicated in Article 29 of Legislative Decree 276/2003) for differentiating service contracts from employment performance supply contracts (*contratti di somministrazione di manodopera*), which are:

a) the organisation of the necessary means by the contractor as a result of (among other things) the contractor's exercise of the authority to organise and direct; and
b) the contractor's assumption of company risk.

The main identifying elements of genuine contracts that relate to the first requirement are:

- the contractor's supply of tools and other material means in the execution of the contract; and
- the contractor's supply of money.

These elements must be established in view of the circumstances in which the contract is carried out, with particular reference to the type of work or service covered by the contract.

The identifying elements that relate to the second requirement are:

- the qualification of the contractor as a company from an economic and organisational perspective;
- the contractor's professional background in the sector to which the contract relates; and
- the difference between the contractor's core business and the client's core business.

However, the assessment of the first requirement may not be limited to verifying whether the contractor has sole arrangement of tools and materials because, as specified in the Rome Labour Court decision, there are contracts in which the supply of tools and financial means is marginal compared to the supply of labour performance.

Today, there are many cases - prohibited under Law 1369/1960 - of contracts in which the material tools are arranged by the same client. A new trend in the first requirement has been demonstrated in case law and confirmed by the Ministry of Employment's Provision 77/2009, whereby a contract is considered genuine if the material means are arranged by the client, but the contractor assumes full responsibility for them, as well as full risk.

These circumstances may particularly arise in the case of software houses – ie, companies whose core business consists of maintaining and managing IT services. Under such contracts, the activities are performed using tools arranged by the client; therefore, the first requirement is fulfilled by the proven know-how of the contractor (ie, the sum of knowledge accrued by a company in a specific sector).

In such hypotheses another legal requirement comes into play - namely, the contractor's ability to direct and organise the employees, indicated by Article 29 of Legislative Decree 276/2003 as a form of organization of means. With reference to this legal requirement the Supreme Court, according to a consolidated principle on this matter, has stated on several occasions that such power over employees may not consist solely of administrative management of employees where there is no real organisation of employees' performances with the aim achieving a productive result (see, among others, Supreme Court decisions 24625 on November 23 2009; 6337 of March 16 2009; and 21010 of October 8 2007).

The power to direct and organise can be said to exist on the basis of certain elements which must be appraised as a whole, and together with other legal requirements, in verifying that a contract is genuine.

In particular, the substantial indicators of such power include the fact that the contractor:

- determines the number of employees to supply to the client in the execution of the contract;
- makes its own choice of which employees to supply to the client;
- replaces absent employees on the basis of its own assessment;
- schedules the working turnover;
- directly controls its employees in the execution of the contract;
- pays its employees and evaluates possible salary increases;
- grants leave and holidays;
- supplies employees with specific ID that differs from that of its client's employees;
- fulfils social security obligations; and
- manages trade union relationships.

Although the powers of direction and organisation mainly reside with the contractor, the client may manage some aspects of employment relationships, provided that the possible management is limited what is termed a 'physiological coordination' with the contractor - for example, although the contractor schedules the working time, the client can indicate time slots for the functional purposes of carrying out the contract.

Supreme Court Decision 12201, which was issued on June 6 2011, is significant in this respect. The court confirmed that physiological coordination between client and contractor is permitted, and that if the client's staff directs the contractor's employees, this does not in itself indicate that a contract is not genuine.

The Supreme Court found that in such cases, the labour court must verify whether the directions given are related to the contractor's power to direct or are ascribable to the result of performance by the contractor's employees. In the first case the contract is not genuine because the arrangement in practice lacks the necessary legal requirement of directing and organisational power.

Ministry of Employment order

On February 5 2011 the Ministry of Employment issued an internal order to clarify some points arising from the complexity of contractual matters. The order incorporated the principles set out by the Supreme Court and the labour courts on contractual matters and specified further elements to be verified in determining whether a contract is genuine.

The ministry went beyond the elements indicated above in respect of the contractor's assumption of company risk, specifying that further substantial elements must be considered evaluating whether a contract is genuine. In particular, it identified the issues of whether the contractor:

- has a company whose business is habitually developed;
- develops its production business in a proven manner; and
- carries out its business on behalf of more than one company simultaneously.

The order also indicates formal elements to ensure that a contract is not part of a fictitious interposition. With reference to the contractor, it identifies:

- entry in a registry of enterprises;
- the maintenance of stocktaking records;
- the existence of a *libro unico del lavoro*, containing information on the employees engaged for the execution of the contract (eg, date of hiring, job titles and qualifications); and
- the existence of a DURC (a document containing data related to social security contributions).

Comment

The labour courts' use of new criteria in judging whether a contract is genuine highlights a changing trend in contractual matters, in line with the provisions of Legislative Decree 276/2003. This difference in approach is due to the increase in the number of companies engaged in the processes of outsourcing and company delocalisation, whereby employers assign entire phases of production cycle to outside contractors. The legislative decree has begun a modernisation process, reforming a framework that was no longer suitable and adapting it to European standards. The new provisions and labour court decisions aim at a trade-off between an employer's interest in developing its business more easily and an employee's interest in having his or her rights safeguarded.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.