

**[DEPARTMENT ORDER NO. 18-02, FEBRUARY 21,
2002, February 21, 2002]**

**RULES IMPLEMENTING ARTICLES 106 TO 109 OF THE LABOR
CODE, AS AMENDED**

By virtue of the power vested in the Secretary of Labor and Employment Under Articles 5 (Rule-making) and 106 (Contractor or Subcontractor) of the Labor Code of the Philippines, as amended, the following regulations governing contracting and subcontracting arrangements are hereby issued:

SECTION 1. Guiding principles. — Contracting and subcontracting arrangements are expressly allowed by law and are subject to regulation for the promotion of employment and the observance of the rights of workers to just and humane conditions of work, security of tenure, self-organization, and collective bargaining. Labor-only contracting as defined herein shall be prohibited.

SECTION 2. Coverage. — These Rules shall apply to all parties of contracting and subcontracting arrangements where employer-employee relationship exists. Placement activities through private recruitment and placement agencies as governed by Articles 26 to 39 of the Labor Code are not covered by these Rules.

SECTION 3. Trilateral Relationship in Contracting Arrangements. — In legitimate contracting, there exists a trilateral relationship under which there is a contract for a specific job, work or service between the principal and the contractor or subcontractor, and a contract of employment between the contractor or subcontractor and its workers. Hence, there are three parties involved in these arrangements, the principal which decides to farm out a job or service to a contractor or subcontractor, the contractor or subcontractor which has the capacity to independently undertake the performance of the job, work or service, and the contractual workers engaged by the contractor or subcontractor to accomplish the job work or service.

SECTION 4. Definition of Basic Terms. — The following terms as used in these Rules shall mean:

(a) "Contracting" or "subcontracting" refers to an arrangement whereby 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, regardless of whether such job, work or service is to be performed or completed within or outside the premises of the principal.

(b) "Contractor or subcontractor" refers to any person or entity engaged in a legitimate contracting or subcontracting arrangement.

(c) "Contractual employee" includes one employed by a contractor or subcontractor to perform or complete a job, work or service pursuant to an arrangement between the latter and the principal.

(d) "Principal" refers to any employer who puts out or farms out a job, service or work to a contractor or subcontractor.

SECTION 5. 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.

SECTION 6. Prohibitions. — Notwithstanding Section 5 of these Rules, the following are hereby declared prohibited for being contrary to law or public policy:

(a) Contracting out of a job; work or service when not done in good faith and not justified by the exigencies of the business and the same results in the termination of regular employees and reduction of work hours or reduction or splitting of the bargaining unit;

(b) Contracting out of work, with a "cabo" as defined in Section 1 (ii), Rule 1, Book V of these Rules. "Cabo" refers to a person or group of persons or to a labor group which, in the guise of labor-organization, supplies workers to an employer, with or without any monetary or other consideration whether in the capacity of an agent of the employer or as an ostensible independent contractor;

(c) Taking undue advantage of the economic situation or lack of bargaining strength of the contractual employee, or undermining his security of tenure or basic rights, or circumventing the provisions of regular employment; in any of the following instances:

- i) In addition to his assigned functions, requiring the contractual employee to perform functions which are currently being performed by the regular employees of the principal or of the contractor or subcontractor;
 - ii) Requiring him to sign, as a precondition to employment or continued employment, an antedated resignation letter; a blank payroll; a waiver of labor standards including minimum wages and social or welfare benefits; or a quitclaim releasing the principal, contractor or subcontractor from any liability as to payment of future claims; and
 - iii) Requiring him to sign a contract fixing the period of employment to a term shorter than the term of the contract between the principal and the contractor or "sub-contractor, unless the latter contract is divisible into phases for which substantially different skills are required and this is made known to the employee at the time of engagement;.
- (d) Contracting out of a job, work or service through an in-house agency which refers to a contractor or subcontractor engaged in the supply of labor which is owned, managed or controlled by the principal and which operates solely, for the principal;
- (e) Contracting out of a job, work or service directly related to the business or operation of the principal by reason of a strike or lockout whether actual or imminent;
- (f) Contracting out of a job; work or service being performed by union members when such will interfere with, restrain or coerce employees in the exercise of their rights to self organization as provided in Art. 248 (c) of the Labor Code, as amended.

SECTION 7. 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.

SECTION 8. Rights of Contractual Employees. — Consistent with Section 7 of these Rules, the contractual employee shall be entitled to all the rights and privileges due a regular employee as provided for in the Labor Code, as amended, to include the following:

- (a) Safe and healthful working conditions;

- (b) Labor standards such as service incentive leave, rest days, overtime pay, holiday pay, 13th month pay and separation pay;
- (c) Social security and welfare benefits;
- (d) Self-organization, collective bargaining and peaceful concerted action; and
- (e) Security of tenure.

SECTION 9. Contract Between Contractor or Subcontractor and Contractual Employee. — Notwithstanding oral or written stipulations to the contrary, the contract between the contractor or subcontractor and the contractual employee, which shall be in writing, shall include the following terms and conditions:

- (a) The specific description of the job; work or service to be performed by the contractual employee;
- (b) The place of work and terms and conditions of employment, including a statement of the wage rate applicable to the individual contractual employee; and
- (c) The term or duration of employment, which shall be coextensive with the contract of the principal and subcontractor, or with the specific phase for which the contractual employee is engaged, as the case may be.

The contractor or subcontractor shall inform the contractual employee of the foregoing terms and conditions on or before the first day of his employment.

SECTION 10. Effect of Termination of Contractual Employment. — In cases of termination of employment prior to the expiration of the contract between the principal and the contractor or subcontractor; the right of the contractual employee to separation pay or other related benefits shall be governed by the applicable laws and jurisprudence on termination of employment.

Where the termination results from the expiration of the contract between the principal and the contractor or subcontractor, or from the completion of the phase of the job, work or service for which the contractual employee is engaged, the latter shall not be entitled to separation pay. However, this shall be without prejudice to completion bonuses or other emoluments, including retirement pay as may be provided by law or in the contract between the principal and the contractor or subcontractor.

SECTION 11. Registration of Contractors or Subcontractors. — Consistent with the authority of the Secretary of Labor and Employment to restrict or prohibit the contracting out of labor through appropriate regulations, a registration system to govern contracting arrangements and to be implemented by the Regional Offices is hereby established.

The registration of contractors and subcontractors shall be necessary for purposes of establishing an effective labor market information and monitoring.

Failure to register shall give rise to the presumption that the contractor is engaged in labor-only contracting.