

Contract of Employment in Sri Lanka: A Contract like Any Other, But a Contract Not like Any Other!

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Abstract - *Contract of employment is a contract relating to employer and employee relationship. The traditional common law considered it as a contract made with free will of the parties. It paved the way for exploitation of employees by their employers because of the unequal bargaining power between the parties. The 'welfare' character of the State has made the State to intervene into the contractual relationship between employers and employees to protect the interests of the employees. The interventions made by the State to redress the unequal bargaining power between the parties have eroded the sanctity of 'contract' in a contract of employment. The objective of this paper is to discuss the extent to which the State has intervened to redress the unequal bargaining power between the parties in a contract of employment, and the effects of those interventions. For the purpose of this research, the provisions of the labour legislation, decided cases and books have been analyzed. The findings show that the State intervention to protect the interests of employees has led to enactment of multitude of labour legislation. The labour legislation provides the terms and conditions of employment, establishes labour courts with just and equitable jurisdiction, promotes collective bargaining and gives legal effect to collective agreements. The provisions of the labour legislation form skeleton to a contract of employment as most of the matters relating to terms and conditions of employment are governed by these legislation. The matters that are not covered by the legislation could become terms of a contract of employment. However, these terms also would be tested in the touchstone of 'just and equitable' by the labour courts. The labour courts have power to create contracts in the absence of formal contracts, create new rights and obligations between parties and disregard unfair contractual terms to award just and equitable reliefs. As the Industrial Disputes*

Act gives legal effect to collective agreements, collective agreements also override the contracts of employment. These interventions and the consequent developments have replaced the traditional common law contracts of employment with just and equitable contracts of employment. Hence, it could be argued that a contract of employment is a contract like any other, but a contract not like any other!

Keywords: State, contract, legislation.

I. INTRODUCTION

Contract of employment is a contract between an employer and an employee. However, contract of employment differs from all other contracts in many aspects and the *sui generis* nature of contract of employment in Sri Lanka promotes ideals of social justice. The 'welfare' and 'socialist' characters of the State make it to intervene into employer-employee relationship as the parties to the relationship do not have equal bargaining power and the imbalance of bargaining power paves the way for exploitation. The interventions made by the State have eroded the sanctity of 'contract' in a contract of employment and made the State as invisible third party in employment contracts.

II. CONTRACT OF EMPLOYMENT AND COMMON LAW

The traditional common law considers that a contract of employment is a contract made with free will of the parties. In common law, civil courts have jurisdiction to award civil remedies for breach of contractual terms in employment contracts. The civil courts, however, do not have power to create contracts in the absence of formal contracts or to create new rights and obligations between the parties. The civil courts cannot

disregard the contractual terms to award reliefs. In this regard, the common law principles and the powers of the civil courts contrast with the principles of labour law and the special powers of the labour courts. In *Vasantha Kumara v. Skyspan Asia (Pvt) Ltd* [2008] Shirani Bandaranayake, J. stated that "...concepts of common law that gave prominence to the rights and duties of employees under their contractual terms...are no longer applicable in our legal system". It reflects the dictum of Lord Devlin in *United Engineering Workers Union v. Devanayagam* [1967] that "...the common law of master and servant has fallen in to disuse". This paper also discusses how the developments in labour law have displaced the common law in employer-employee relationship.

III. EMERGENCE OF WELFARE STATE

Emergence of welfare state has a significant impact on employer and employee relationship as well. Welfare State recognizes that in employment relationship, there is no equal bargaining power between employers and employees and the employers are in a superior position to dictate the terms of a contract of employment and the employees' capacity to resist the unfair terms is minimal because of socio-economic reasons. Hence, the State intervenes to protect the weaker party of the society from exploitation. The State intervention to protect the interests of employees has led to enactment of multitude of labour legislation. The labour legislation, *inter alia*, provides the terms and conditions of employment, establishes labour courts with special powers, and promotes collective agreements. These provisions in the labour legislation have radically changed the nature of contract of employment. Hence, in *Sri Lanka Insurance Corporation Ltd v. Jayathilake* [2008] Shiranee Tilakawardane, J. stated that "...equity also permits the corporate world the freedom to operate within a mutually agreed contract as long as the dominant power of the employer is not used to exploit the services of the workman..". The interventions of the State protect the workmen from exploitation from dominant power.

IV. NON-WRITTEN FORM OF CONTRACT OF EMPLOYMENT

The question arises whether a contract of employment should be in writing to be enforced. The interpretation to the word 'workman' in the

Industrial Disputes Act provides that 'workman' means "any person who has entered into or works under a contract with an employer in any capacity, whether the contract is expressed or implied, oral or in writing..." (S.48). Many other labour legislation also have similar interpretation to the word 'workman'. Hence, a contract of employment could be in the form of implied or oral agreement. If such interpretation is not given, the objective of the legislation may be defeated.

The Shop and Office Employees Act provides that "Every employer by whom any person is employed in or about the business of any shop or office shall furnish such person on the date of his employment with such particulars as may be prescribed relating to the conditions of his employment" (S.17). As it provides 'employed by him' the requirement to provide the particulars is not a pre-requisite to form a contract of employment. If an employer does not furnish the prescribed particulars, it would become violation of the provision of the Act. Providing the particulars by an employer would confirm existence of a contract of employment, but failure to provide the particulars would not negate existence of a contract of employment.

The question arises that whether a contract of employment would exist when a clause in a contract expressly provides that the contract is not a contract of employment. The labour courts established under the Industrial Disputes Act are not fettered by the terms in a contract. They would consider the facts and decide whether a contract of employment exists or not. The labour legislation also have provision against 'contracting out' to prevent the parties entering into agreements against the provisions of the legislation to defeat the objective of the legislation. Hence, the Commissioner of Labour also has powers to consider the facts and decide whether a contract of employment exists or not.

V. IMPLIED TERMS OF A CONTRACT

As a contract of employment deals with rights, duties and obligation of the parties, it will have express terms agreed by the parties. However, it is not possible to pre-determine and include terms in relation to all aspects of employment in a contract of employment. Contingencies may arise that are not covered by the express terms of a contract of employment. In such situations, implied terms

may arise from the duties and obligations of the parties and the courts will have to recourse to the implied terms to decide the contingencies.

In *Sterling Engineering Co Ltd v. Patchett* [1955], Lord Reid stated that "... an implied term is something which, in the circumstances of a particular case, the law may read into the contract if the parties are silent and it would be reasonable to do so; it is something over and above the ordinary incidents of the particular type of contract". In *Cresswell v. Board of Inland Revenue* [1984], the court accepted the implied term that an employee shall adapt new skills and techniques in the course of employment. In this case, the court held that the requirement to change the method of work from dealing manually with the files and records to computerized system was a reasonable expectation of the employer. The court also stated that it is not doing a different job, but doing the same job in a different way. In *Malik v. Bank of Credit and Commerce International SA (in liquidation)* [1997], the House of Lords recognized the implied term of 'trust and confidence' in employer – employee relationship. In *Mears v Safecar Security Ltd* [1983], the Court held that all facts and circumstances including the manner the parties have carried out the contract should be considered to imply a term into a contract of employment.

As Sri Lanka is a state party to important international instruments relating to human rights and all core conventions of the International Labour Organization, the principles in these international instruments also may be considered as implied terms of contract of employment if they do not conflict with the legislation of Sri Lanka.

Another related concept is 'overriding terms' in a contract of employment. The Courts consider certain terms are important and fundamental to any contract of employment. The terms relating to 'trust and faithfulness', 'duty of care' and 'health and safety' are some examples. As these obligations go to the root of a contract of employment, the courts imply these overriding obligations even against the express terms in contracts.

In Sri Lanka, the Industrial Disputes Act expressly provides that collective agreements, settlements in conciliation and awards of arbitrators and industrial courts become implied terms of

contracts of employment. Thus, the Industrial Disputes Act paves the way to make inroads into contracts of employment and implant implied terms and overriding terms.

VI. CONTRA PROFERENTEM RULE

Contra proferentem is a rule of interpretation of contracts which provides that an ambiguous term in a contract will be construed against the party who has included the term in the contract. As employers who have dominant power include terms in contracts of employment, the rule is very useful to interpret the contracts of employment in a manner that would prevent exploitation of workers by using ambiguous words. In *State Distilleries Corporation v. Rupasinghe* [1994] Fernando, J. stated that "...If the contractual terms are ambiguous, or admit of more than one interpretation, both equity and the principles of interpretation concur in requiring that they be interpreted *contra proferentem*, against the Employer and in favour of the applicant". In the Fiji case of *Suva City Council v. Koroi* [2013] Chandra, J. authoritatively cited the dictum of Fernando, J. in *Rupasinghe case* to interpret a clause relating to probationary employment. This rule provides another weapon to the armoury of the labour courts.

VII. LEGISLATIVE INTERVENTION

The legislative intervention into employer-employer relationship to redress the unequal bargaining power between the parties has led to plethora of labour legislation in the country. There are about thirty legislation which provide for wide range of issues including terms and conditions of employment, settlement of disputes and social security.

In *Singer Industries (Ceylon) Ltd v. Ceylon Mercantile Industrial and General Workers Union* [2010] Chandra Ekanayake, J. stated that "...With the objective of adjusting and declaring the rights of parties consistent with the need to ensure fairness and equity, the state has brought in legislative regulations to restore the balance of power between the parties. Therefore industrial contracts unlike the normal contracts, are partly contractual between the employer and employee, and also partly non contractual, in that the State by means of legislature or through industrial adjudication, may prescribe many of the

obligations that an employer may owe to his employees". It explains the difference between industrial contracts and other contracts.

Labour courts and the Commissioner of Labour interpret the labour legislation which provide rights and obligations to the parties in employment relationships. When they interpret the legislation, they should adopt the beneficent rule of interpretation to achieve the objective of the legislation. In *Mahadeo Dhondu Jadhav v. Labour Appellate Tribunal* [1955], Chagla C.J stated that "...we are always most reluctant to put any interpretation upon labour legislation which is likely to prejudice the rights or welfare of labour... we should not, unless we are compelled to do so by the clear language used by the Legislature, put any construction upon any provision of labour legislation which will in any way prejudicially affect their rights".

Any contract against the provisions of the legislation and to be detrimental to the workmen is illegal and null and void. The legislation also have express provisions against contracting out. The legislative interventions have deprived the contractual freedom of the parties to a greater extent and diluted the importance of 'offer' and 'acceptance' principles which are *sin qua non* to any contract.

VIII. CONCILIATION AND ARBITRATION

Conciliation is a mechanism provided in the Industrial Disputes Act to settle an industrial dispute by a 'fair and amicable' settlement agreed by the parties (S.11(1)). The settlement binds the parties and the clauses in the settlement become implied terms of the contract of employment between the parties (S.14). Violation of these terms becomes an offence under the Industrial Disputes Act (Ss 40(1)(a) and (b)).

Arbitration is a mechanism provided in the Industrial Disputes Act to settle an industrial dispute by determination of an arbitrator. The arbitrator has to conduct an inquiry and hear evidence and thereafter he has to make a just and equitable award (S 17(1)). The award binds the parties and the terms of the award become implied terms of the contract of employment between the parties (S.19). Violation of these terms also becomes an offence under the Industrial Disputes Act (Ss 40(1)(a) and (b)).

The question arises whether an industrial arbitrator is fettered by a contract of employment when he makes just and equitable award. In *State Bank of India v. Edirisinghe* [1991] Justice Tambiah J stated that "...an Industrial Arbitrator is not tied down and fettered by the terms of contract of employment between the employer and the workman. He can create new rights and introduce new obligations between the parties". The powers of an industrial arbitrator to disregard the contracts and create new rights and obligations undermines the importance of contracts in employer-employee relationships.

IX. LABOUR TRIBUNALS

Labour Tribunals have jurisdiction to hear applications relating to termination of services and payment of gratuity if the employees are not covered by the Payment of Gratuity Act (Ss. 31B (1) (a) and (b)). The Industrial Disputes Act empowers Labour Tribunals to make just and equitable decisions (S.31 C(1)). The Act expressly provides that when a Labour Tribunal makes its order upon an application made by a workman for relief, the Tribunal is not fettered by a contract of employment (S.31B(4)). If a Tribunal is fettered by a contract of employment which has unfair clauses, the Tribunal will not be able to make just and equitable orders. Hence, the power given to a Labour Tribunal to disregard contract of employment is very important to exercise its predominant duty of making just and equitable orders.

In *Caledonian (Ceylon) Tea and Rubber Estates Ltd v. Hillman* [1977] Sharvanandha J stated that "...The jurisdiction that is vested in a Labour Tribunal by the Industrial Disputes Act is not a jurisdiction of merely administering the existing common law and enforcing existing contracts. The relations between the employer and his workman are no longer governed by the contract of service. The Tribunal has the right, may the duty, to vary contracts of service between the employer and the employee - a jurisdiction which can never be exercised by a civil Court...". However, the powers of a labour tribunal to create new rights and obligations are limited by the jurisdiction and reliefs available from a labour tribunal. As discussed in the *Walker Sons and Co Ltd v. Fry* case [1965], the powers of an industrial arbitrator is very much wider than the powers of a Labour Tribunal to create new rights and obligations.

X. TERMINATION CLAUSES

In common law, the parties to a contract of employment can terminate the contract in accordance with the terms of the contract. Any breach of the contract by a party entitles the other party to claim damages for the breach of the contract. According to the Industrial Disputes Act, Labour Tribunals have jurisdiction to hear cases relating to termination of services by employers (S.31 B (1) (a)). The provision in the Act is very carefully worded to prevent closure of the gateway to a Labour Tribunal depending on contractual terms.

In *Independent Industrial and Commercial Employees' Union v. Board of Directors, Co-operative Wholesale Establishment* [1971], All. J. stated that "...the Industrial Disputes Act does not refer to the termination of the contract of employment (which is a subject more appropriate to the law of contract) but to the termination of the services of the workman because the Act is not concerned primarily with the contract of employment but rather with the special relations between the employer and the workman necessary to promote industrial peace and establish harmonious relations between them". Hence, a workman could file an application in a labour tribunal even though the termination is in accordance with contractual terms.

In *United Engineering Workers' Union v. Devanayagam* [1967] the Privy Council observed that "Section 31B(1) does not say that a workman can apply for relief in respect of the wrongful termination of his services. It merely says that he can apply in respect of the termination of his services. This omission of the word 'wrongful' is significant". Hence, a rightful termination according to the contractual terms would not prevent a workman seeking relief from a labour tribunal.

The above discussion explains that a clause in a contract of employment such as either party could terminate the contract of employment by giving notice cannot be relied on by an employer to terminate the services of his workman if the termination is not justifiable. A Labour Tribunal has powers to disregard such clause as the Labour Tribunal has to consider not whether the termination is in accordance with contractual

terms or not, but whether the termination is justified or not.

XI. JURISDICTION OF DISTRICT COURTS

District Courts are civil courts and they make decisions according to the terms of the contracts. In employment matters, if a workman chooses to seek relief in a District Court, the District Court would decide the case according to the contractual terms. Before the establishment of Labour Tribunals, termination cases were filed in District Courts and the Courts decided the cases according to the contractual terms and provided civil remedies. In this regard, Labour Tribunals differ from District Courts as Labour Tribunals make orders for reinstatement or compensation without fettered by contractual terms. In *Fernando v. Standard Chartered Bank* [2011], the Supreme Court held that a workman who complains unlawful termination of his services could seek relief from a District Court, if he has not sought any relief from a Labour Tribunal. In comparison, Labour Tribunal is the best forum for a workman to file application for termination of his services as Labour Tribunals have powers to grant just and equitable reliefs unfettered by contracts of employment.

XII. SETTLEMENT OUT OF COURTS

Settlement out of court is also a form of an agreement between the parties. As the main objective of the Industrial Disputes Act is to promote settlement of industrial disputes, such settlements are in consonance with the scheme of the Act. However, such settlements may be amicable settlements but not fair settlements. If such settlements are not fair settlements they are not in consonance with the scheme of the Act. The question arises whether Labour Tribunals are bound by the settlements out of courts. Section 31B(2)(a) of the Act provides that in relation to an application filed before a Labour Tribunal, if a settlement is reached between the employer and a trade union of the workman, the Labour Tribunal shall make order according to the terms of such settlement. As it provides for a settlement reached between an employer and a trade union, the question arises as to the extent to which a settlement reached between an employer and a workman would bind Labour Tribunals.

In *Talayaratne v. Air Ceylon Ltd* [1986], Jayalath, J. stated that “Settling ‘out of court’ is indeed a commendable act of the employer so long as the employee is treated fairly and reasonably. Even if an employee signs a receipt “in full and final settlement of all claims due to me statutory or otherwise,” this does not preclude an employee from applying to a Labour Tribunal to receive what is legally due to him. What the Tribunal has to ascertain is whether the settlement has been ‘fair and reasonable’”.

In *Premawathie v. Fowzie, Minister of Health* [1998] while a fundamental rights case was pending, a settlement was proposed by the parties. In this case, Fernando, J. stated that “The terms of settlement do not adequately redress the wrong that has been done to her. Once this court grants leave to proceed, Article 126 imposes a duty to make an order which is just and equitable, and so we cannot merely give effect to a settlement proposed by the parties. In this case, the Supreme Court was of the opinion that the settlement was not a just and equitable one.

Section 31B (2) (a) and the scheme of the Act do not oust ‘settlement out of court’ if the settlement is a just and equitable one. Section 47 A of the Act provides that any contract or agreement which is in detrimental to the rights conferred on a workman by the Act or against the liability imposed on an employer by the Act is null and void. What is ‘legally due’ under the Industrial Disputes Act is what is ‘just and equitably due’ under the Act. Hence, a Labour Tribunal could give effect to a settlement reached between an employer and a workman if it is a fair settlement. If not, it may counter the combined effect of sections 31B (4) and 31 C (1) of the Act as well.

XIII. UNILATERAL VARIATION OF CONTRACTUAL TERMS

The parties to a contract of employment have the freedom to mutually vary the terms of a contract of employment. In *Lanka Salu Sala Ltd v. Wickremanayake* [1975], age of retirement has been unilaterally varied from age of 60 years to age of 55 years. The Supreme Court followed the principle of non-acceptance of unilateral variation of terms by a party and held that the variation is not justified in the circumstances as the workman had completed 24 years of service with the term

which allowed him to work until the age of 60 years.

In *Singer Industries (Ceylon) Ltd v. Ceylon Mercantile Industrial and General Workers Union* [2010], the Union made a proposal for payment of gratuity in excess of the amount provided by the Payment of Gratuity Act, No 12 of 1983. In response to the demand, the Company offered $\frac{3}{4}$ of a monthly salary to employees with more than 20 years of service. The Union rejected the offer and made a counter proposal. The Company in turn rejected the counter proposal and stated that initial offer will not be varied. However, finally when a dispute arose the Company took a stance that no agreement or consensus had been reached with regard to enhanced payment of gratuity.

When the dispute has been referred to an arbitrator, the arbitrator held that “In the field of industrial relations the principles of offer and acceptance should not be strictly adhered to. In the law of contracts a counter offer can destroy an offer but in labour relations I hold the view that a counter offer or a counter proposal can keep the original offer alive...”. But the Supreme Court rejected the view and emphasized on offer and acceptance and consensus in the minds of the contracting parties. The Supreme Court held that “...the general principles of law of contract apply to the creation of a contract of industrial employment. Thus the ordinary principles of law of contract such as ‘offer’ and ‘acceptance’ and ‘consideration’ therefore apply to the formation of a valid industrial contract”. It could be said that the above dictum recognizes the consensual variation of terms and conditions of employment.

However, the Labour Courts which have jurisdiction to make just and equitable decisions unfettered by the contracts of employment could disregard even the terms and conditions which have been consensually varied by the parties if such terms and conditions are not fair and reasonable. Therefore, unilateral variation of contractual terms against the interests of employees would not survive if they are not fair and reasonable.

XIV. COLLECTIVE AGREEMENTS

The Industrial Disputes Act provides for compulsory recognition of trade unions for collective bargaining if the trade unions represent

not less than 40% of the workers (S.32A(g)). According to the Act, collective agreement means an agreement between an employer and workmen or trade union relating to terms and conditions of employment, rights, duties and obligations of the parties and settlement of disputes (S.5(1)). A collective agreement which is the fruit of a successful collective bargaining binds the parties (S.8(1)) and violation of a collective agreement is an offence (Ss 40(1)(a) and (b)). Therefore, if there is any conflict between a contract of employment and a collective agreement, collective agreement would override the contract of employment.

XV. CONCLUSION

The above discussion explains how the interventions made by the State to redress the imbalance between the contracting parties have made 'contract' in industrial relations is a unique one. The interventions make 'fairness' as a touchstone of contract of employment. De Silva states that "...in our labour law it may fairly be concluded that in the sphere of industrial employment law the jurisprudence is based not on the idea of 'agreement' that is reflected by the contract in classical theory but on the necessity for 'fairness or equity' " (De Silva, 2012). In certain circumstances, fairness and equity pave the way to create a contract of employment without a contract and in some other circumstances, fairness and equity pave the way to destroy a contract to create a contract of employment. Hence, it could be argued that a contract of employment is a contract like any other, but a contract not like any other!

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