SRI LANKA INSURANCE CORPORATION LTD.
v
JAYATHILAKE

SUPREME COURT.
S.N. SILVA, C.J.
SHIRANEE TILAKAWARDANE, J. AND
SOMAWANSA, J.
S.C. APPEAL NO. 23A/2008
S.C. (H.C.) L.A. NO. 32/2007
H.C.A.L.T. NO. 1037/2005
L.T. NO. 02/418/2004
FEBRUARY 11th, 2008

Refusal to extend an otherwise expired contract of employment – Does it amount to an 'unjust termination' or 'constructive termination' of employment of the workman? – Does it warrant relief under the Industrial Disputes Act? – Reasons for refusal not given – Is it fatal?

The Supreme Court granted leave to appeal in recognition of the fact that there had been, and continues to be, a growth of similar such claims in the Labour Tribunals, which seek judgment against the employer for refusing to extend an otherwise expired contract of employment as an "injust" termination or "constructive termination" of employment.

Held:

(1) When a contract of employment expires, it ends by the operation of the law, and privileges which could not be reasonably envisaged with the terms of the contract cannot be assumed or obtained beyond the scope of the ambit of the contract unless any rules or policies adopted by the employer-employee contract permits an extension of employment.

(2) In adjudicating claims such as the present one, equity also permits the corporate world the freedom to operate within a mutually agreed contact, as long as the dominant power of the employer is not used to exploit the services of the workman, as the just and equitable relief must be assured to both parties who seek redress to the labour courts.

(3) Where employers choose to provide employees with the right to apply for extensions of employment, they are under a duty to decide upon such extensions in a reasonable and just manner, even when such decisions are within their sole discretion.

(4) In determining the merits of a decision to refuse an extension, the following three matters have to be considered and examined by the Court through consideration of evidence and testimony proffered by both parties as to the existence or non-existence of each.

(i) There has been no employee misconduct alleged or if misconduct has been alleged, employer failed to adequately investigate and resolve the matter.

(ii) Employer does not have a policy of evaluating applications or extensions of employment that includes consideration of factors such as absence of misconduct, length of employment and employee ability.

(iii) Employer failed to evaluate the application for extension of employment.

If, and only if, the Court finds that the employee is able to establish no less than two of the above considerations in its favour, then the Court is able to apply the principal of constructive termination as contained in the Industrial Disputes Act upon the grounds that, as a matter of law, the employer has made an unreasonable refusal to extend employment, and by so doing has constructively terminated the employee.

Per Shiranee Tilakawardane, J.

"It is my view that the petitioners failure to provide reasons for denial of the respondents application may indicate a less than optimal business operation, but does not by itself necessarily suggest. Let alone require one to conclude, the inverse proposition namely, that the application was denied without reason."

Cases referred to:

1. *Sri Lanka Insurance Corporation Limited* v *D.N.W. Jayasundara* HCALT 98/2006, SCLTA.
2. *Shanmugam* v *Maskeliya Plantation Limited* 1996 1 Sri LR 208.

APPEAL from judgment of the High Court (exercising provincial appellate jurisdiction).

Sanjeewa Jayawardane for the appellant.
Chamantha Weerakoon Unambuwa with *Dhammika Jayawardane* for the respondent.

Cur.adv.vult.

June 26, 2008

SHIRANEE TILAKAWARDANE, J.

This Court granted the respondent-appellant-petitioner (hereinafter referred to as the "Petitioner") special leave, on the question of law stated in paragraph 23(a) of the petitioner's petition, namely, whether the High Court (as defined herein) fell into substantial error by holding that the petitioner's refusal to extend the respondent's service gave rise to a "constructive termination" of the applicant-respondent-respondent (hereinafter referred to as the "respondent").

This Court granted leave to appeal in recognition of the fact that there had been, and continues to be, a growth of similar such claims in the Labour Tribunals, which seek judgment against an employer for refusing to extend an otherwise expired employment contract as an "unjust" termination or "constructive termination" of employment.

The High Court dismissed the petitioner's Appeal to set aside the Labour Tribunal's order dated 1st August 2008 and upheld the order of the Labour Tribunal that the petitioner's refusal to grant the respondent's application for continued employment was an unjust and unreasonable "termination", warranting relief under the Industrial Disputes Act.

A review of the written submissions to both this Court and the lower Courts as well as a review of the evidence submitted at the lower court hearings, reveals the facts of the case relevant to this Court's decision to be as follows:

(i) Though successor to a government corporation, the petitioner is now a private limited liability company duly incorporated under the laws relating to Companies in Sri Lanka.

(ii) Until the petitioner's refusal to extend respondent's employment, the respondent worked for the petitioner as a Grade III employee in the post of "Executive", having commenced employment with the petitioner's predecessor in 1970 as a Grade V employee.

(iii) Though the Respondent's employment contract does not contain express rules on retirement, it does, however, expressly bind respondent to agreement and compliance with the petitioner's corporate policies and rules, as they may be amended from time to time.

(iv) An amendment dated 4th June 1998 to Clause 1 of Chapter VII of the Administrative Procedural Handbook of the petitioner, sets out a policy of retiring an employee at the age of 55, subject to the approval of the employee's application for extension of employment. Under cross-examination at the Labour Tribunal hearing, the respondent conceded his awareness of this amendment and the Policy it contained.

(v) The respondent's letter of warning alleged that the respondent had violated his duty of loyalty to the petitioner by attempting to divert business from the corporation for personality remunerative reasons, and this resulted in a deferment of the respondent's salary increments.

(vi) On or about December 2003, the respondent filed an application for extension of his employment past the age of 55 years. This was refused and having informed him, the respondent's services with the company ended on 20th March 2004, the day he reached the age of 55.

In the area of employment and Labour law, the law must serve two, often competing purposes and must do so by achieving a precarious balance between the two. On one hand, the courts are duty-bound to protect the rights of the workman from corporate bullying and an abuse of corporate power, as the workman is clearly the lesser-empowered of the two parties. Indeed the very creation of Labour law itself is a result of the need to place checks and balances on capricious abuse of the more dominant power of the employer's action. However, in seeking to achieve such protection, the courts must take care to avoid eroding upon the right of employers and, indeed, corporations in general, to freely negotiate the relationship they choose to hold with their employees and the autonomy they are afforded as private entities under the laws governing corporate existence.

In adjudicating claims such as the present one, 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, as the just and equitable relief must be assured to both parties who seek redress to the labour courts. When a contract expires, it ends by the operation of the law, and privileges which could not be reasonably envisaged within the terms of the contract cannot be assumed or obtained beyond the scope of the ambit of the contract unless any rules or policies adopted by the employer-employee contract permits an extension of employment. In *Sri Lanka Insurance Corporation Limited* v *D.N.W. Jayasundera*[1], where the facts were very similar to the present case and against the petitioner, the court noted that:

> "*When the contract of employment has come to an end there would be no termination of the contract. Thus it would be an automatic ending of the contract by the operation of the law as a result of ending the life span of the contract of service. The discretion to grant an extension is with the employer and the refusal to grant an extension would not affect the status of the former contract as the former contract remains expired and unchanged. Even if the extension in fact had been*

granted by the employer it would only either renew the former contract by extending the life of the former contract or replace the former contract with a new contract all together."

Learned Counsel for the petitioner essentially submitted that this settled the matter. But while viewing refusals of extensions under the purview of contract law preserves the integrity of "the contract" as a product of free will and desire of those who choose to become party to one, the aforementioned balance between employer and employee rights, in terms of the spirit of the Industrial Disputes Act, requires that this Court recognizes the power imbalance between the two, and the very real means by which an employer can effect termination of an employee without affirmatively acting in that regard. In doing so, this Court has repeatedly held that where employers choose to provide employees with the right to apply for extensions of employment, they are under a duty to decide upon such extensions in a reasonable and just manner, even when such decisions are within their sole discretion. in the case of *Shanmugam* v *Maskeliya Plantations Limited*(1) reference was made to this in the following manner:

"Mr. Mustapha (Counsel for the appellant) rightly conceded that the appellant has no contractual right to an extension in service after the optional age of retirement, namely 55 years. Admittedly, the appellant was granted 3 extensions of service after he reached 55 years but was refused his 4th extension of service. The question then is whether the refusal of the 4th extension was justified in the particular facts and circumstances of this case. This was the true issue before the arbitrator and I agree with Mr. Mustapha that the arbitrator erroneously viewed the dispute largely, if not, entirely, as a matter of contractual entitlement."

In determining the merits of a decision to refuse an extension, I hold that three matters have to be considered and examined by the court, through consideration of evidence and testimony proffered by both parties as to the existence or non-existence of each if, *and only if,* the court finds that the employee is able to

establish,by a preponderance of the evidence, *no less than two of the considerations* in its favour, then the court is able to apply the principal of constructive termination as contained in the Industrial Disputes Act (and award appropriate relief) upon the grounds that, *as a matter of law*, the employer has made an unreasonable refusal to extend employment and, by so doing, has constructively terminated the employee. The three matters that need to be considered when arriving at a determination on this matter are:-

1. *There has been no employee misconduct alleged or if misconduct has been alleged, employer failed to adequately investigate and resolve the matter.*
2. *Employer does not have a policy of evaluating applications or extensions of employment that includes consideration of factors such as absence of misconduct, length of employment, and employee ability.*
3. *Employer failed to evaluate the application for extension of employment.*

On these principles, and on analysis of the facts of this case, it is pertinent that at the Labour Tribunal inquiry the Learned Counsel for the respondent submitted, and the High Court later found that one instance of misconduct was alleged against the respondent as evidenced by a warning letter (*X-4* in the proceedings of the Labour Tribunal), though no evidence of any formal inquiry or official corporate resolution of the matter was presented by the petitioner that would establish its claim of refusing the extension due to the respondent's prior misconduct. The High Court's rejection of the petitioner's contention was, in effect, a determination that the respondent had established the first of the three matters listed above. However, unlike the High Court who saw fit to affirm the Labour Tribunal's order based, in large part, upon finding the petitioner's misconduct claim invalid, our scrutiny and analysis of the instant case must extend to the second and third matters set out above.

A review of the evidence submitted by learned Counsel for the petitioner reveals the submission of a 4th June 1998 amendment (the

"Amendment" to Clause 1 of Chapter VII of the Administrative Procedural Handbook of the petitioner (*X-2* in the proceedings of the Labour Tribunal), which in turn reveals that the petitioner holds a policy of retiring an employee at the age of 55, subject to the approval of the employee's application for extension of employment. According to the Chapter, approval of such extensions lay in the sole discretion of the Chairman (or the Board of Directors, if so decided by the Chairman), and in either case, the decision will take into account several factors relating to the health, ability and history of service of the employee. Furthermore, the Chapter reiterates that an employee's failure to submit an application or to obtain approval of an application for extension results in the retirement of the employee. By this evidence, petitioner has unequivocally established that petitioner indeed has a policy regarding extension applications that requires deliberation and evaluation in the decision-making process. Respondent is *per se* unable to counter the 2nd requisite set out above, and in fact, conceded under cross-examination his awareness of both this Amendment and of the Policy.

The only submission by the learned Counsel of the respondent relating to the petitioner's alleged failure to evaluate the respondent's application is his contention that no reasons are provided to the respondent in the letter notifying him of the petitioner's denial of his application. It is my view that the petitioner's failure to provide reasons for denial of the respondent's application may indicate a less-than-optimal business operation, but does not by itself necessarily suggest, let alone require one to conclude, the inverse proposition – namely, that the application was denied without reason. While this Court recognizes the need to place limits on the extent of corporate autonomy in the context of employment procedures, we are not willing to extensively intrude on ministerial practices such as the manner and format of employee notifications. The petitioner, by its own policy, does not require reasons for denial to be made known upon issuances of extension denials, and I do not see reason to mandate otherwise. Accordingly, the respondent failed to establish at least two of the grounds set out above, and having only established one of the three grounds. I conclude that the High Court erred, as a matter of

law, in holding that the employer's mere denial of an extension was an unreasonable refusal constituting a "constructive termination" of employment.

It may be apparent from the above analysis that the above tests – in essence a codified and expanded version of the analysis already used by the courts – places a significant burden upon the employee, as it requires the employee to clearly establish multiple failures on the part of the employer in order establish the "wrongdoing" of an employer.

I think that it is important to establish this burden for multiple reasons. First, as such allegations of employer purported wrongdoings can be fiscally and reputationally disastrous to the Employer Company, the task of establishing wrongdoing on the part of an employer to whom an employee has voluntarily joined, should, in fact be an explicit requirement in order to preclude frivolous and baseless allegations. Indeed placing such an increase in the threshold requirement, which claims must pass in order to seek relief will, this Court believes, serve to reduce the number of these "extension refusal" cases being initiated to only those that are truly with merit. Second, to ease the existent burden of the employee in establishing employer wrongdoing would, in effect, shift the burden to the employer to establish its own innocence, creating several "perverse incentives" for the employer – false accusations and inquiries of misconduct, as one example – that would ultimately harm all employees in the long-run.

For the reasons above, I hereby set aside the decision of the High Court and dismiss the respondent's application to the Labour Tribunal with costs.

S.N. SILVA, C.J. - I agree.

SOMAWANSA, J. - I agree.

Appeal allowed, decision of the High Court set aside.
Respondents application to the Labour Tribunal dismissed.