Distinction Between A Contract For Service & A Contract Of Service

(article by b mathew- an extract from RIGHT TOLIVELIHOOD & EMPLOYMENT DISMISSALS by B Mathew)

When an independent self-employed man provides his skills, tools and human resources to independently without supervision to undertake and complete a specific job for another, then he is said to having entered into a contract for service. As contrast to a contract of service, which is an employment contract, a contract for service is a commercial contract.

There is a marked distinction between a "contract for service" and a "contract of service:

A person who is "self-employed" or a self-employed person who offers or provides services in consideration for fees or service charge is said to be under a contract FOR service. He acts as a freelance vendor not for a single recipient client / customer but for multiple recipient clients / customers.

Whereas a person who is actively employed by another for a specific salary / wage in consideration of performing specific job is said to be under a contract OF service.

It becomes incumbent upon us to take cognizance of this marked distinction because of various ensuing rights, entitlements and privileges attributed respectively to these 2 types of employment contracts. For example this could be in respect of entitlements to minimum wages, holiday pay, sick leave, fair dismissal, the right to organize a union, and so on.

Sir Otto Kahn-Freund, a professor of comparative law, defines a contract of service as follows;

"the relation between an employer and an isolated employee or worker is typically a relation between a bearer of power and one who is not a bearer of power. In its inception it is an act of submission, in its operation it is a condition of subordination, however much the submission and the subordination may be concealed by the indispensable figment of the legal mind known as the 'contract of employment'. The main object of labour law has been, and... will always be a countervailing force to counteract the inequality of bargaining power which is inherent and must be inherent in the employment relationship…[1]

However, this definition may not be true to its letters presently, because of the dynamics of sociological, economic and technological changes tilting in favour of employee "servants". As skills become rare supply and demands for skills increase, employers of today may not be "masters" to dictate their terms anymore. In contrast, employers may turn out to be servants of highly, rare skilled workers who actually control the life-blood of a business entity and in particular if the business organization is critically dependent on these rare skills.

Not only are the definitions important for these two types of services, but the distinctions are equally important because the law has created and / or evolved many "Rights" for those under a contract of service. The law assumes that those under a contract of services are in a weaker position as compare to those under a contract for services, and therefore they are not capable of protecting their rights since those under a contract of service do not stand in equal footing with those employing them. Whereas the law assumes that those under a contract for service stand in equal footing with their clients / customers, hence the law says that those under a contract for service are capable of protecting their own rights.

Let us now look at the following example where the Malaysian Industrial Relations Act 1967 has created a "Right" for those under a contract of service:

Section 2 of IRA 1967 *"workman" means any person, including an apprentice, employed by an employer under a contract of employment to work for hire or reward and for the purposes of any proceedings in relation to a trade dispute includes any such person who has been*

[1] *Labour and the Law, Hamlyn Lectures, 1972, 7*

dismissed, discharged or retrenched in connection with or as a consequence of that dispute or whose dismissal, discharge or retrenchment has led to that dispute.

Section 20(1) of IRA 1967 *Where a workman, irrespective of whether he is a member of a trade union of workmen or otherwise, considers that he has been dismissed without just cause or excuse by his employer, he may make representations in writing to the Director General to be reinstated in his former employment; the representations may be filed at the office of the Director General nearest to the place of employment from which the workman was dismissed.*

Here the Act, clearly defines a "Workman" as someone strictly under a contract of employment only. This definition clearly excludes anyone under a contract for service. As such, anyone dismissed under a contract of service or those whose contract of service has been terminated has a right to representation under section 20(1) of the Industrial Relations Act 1967. But those dismissed under a contract for services or those terminated under a contract for services have no right to this representation under section 20(1) of the Industrial Relations Act 1967.

2.1 The distinguishing tests

Section 2 (1) of the Malaysian Employment Act 1955 (EA 1955) gives a vague or rather a shallow definition and distinction of a contract of service and a contract for service;

"contract of service" means any agreement, whether oral or in writing and whether express or implied, whereby one person agrees to employ another as an employee and that other agrees to serve his employer as an employee and includes an apprenticeship contract;

"contractor" means any person who contracts with a principal to carry out the whole or any part of any work undertaken by the principal in the course of or for the purposes of the principal's trade or business;

Therefore, it becomes incumbent upon the presiding courts eg the industrial & labour courts to have a recourse to a number of established benchmarks to establish distinctions between a contract of service and a contract for services.

Mutuality of Obligation test

Under this benchmark, that is in respect of a contract of service,

- the employer has an obligation on his part to provide continuous flow of work for the employee,
- and the employee has an obligation on his part to complete the continuous flow of job provided by his employer.

In other words, it is a continuous flow of assignments, without interruptions on a regular basis, from the employer and continuous completion of these given assignments by the employee.

Now this would be somewhat different for someone who is under a contract for service, as he is only obliged to complete the agreed task or job and thereafter his obligation ceases. Following this break, another agreement could begin to commence and complete another job. It is this element of non-continuous, intermittent breaks in between jobs that distinguishes a contract for service from a contract of service.

In the case of Younis v Trans Global Projects Ltd[2], Mr. Younis was engaged as a consultant for the company's business development. There was a mutual agreement between them that the company would provide the business leads and thereafter he would work on these provided leads to establish the necessary business links and developments for the company. And in consideration of his business development services, the company paid a daily rate of payment for each day worked, including that of covering the disbursement expended during his regular work and a specified bonus sum on business deals he secured.

[2] *EAT 02.12.05*

Two years later the company terminated his engagement and Mr. Younis filed a claim against the company for unfair dismissal and a breach of his contract of employment. The first instant employment tribunal ruled interalia that this case failed the test of Mutuality of Obligation between the contending parties and therefore Mr. Younis was merely engaged under a contract for services. In the premises, the company was not obliged to provide Mr. Younis any business leads continuously and neither was he obliged to complete any follow up business leads given by the company.

However, on appeal, the employment appeal tribunal (EAT) ruled that mutuality of obligation between the two parties did exist; the EAT said, *"in the ordinary case…the question is whether the employer is under an obligation to provide work and the worker to do it, when offered"*.

The appeals tribunal in answering the foregoing question in the affirmative added that Mr. Younis was indeed under an obligation to bring in his business contacts to the company and the company was under an obligation to work on these business contacts. Nevertheless, the EAT concluded, although the case satisfied the mutuality of obligation test, it did not satisfy the Control Test, that is, the required level of control exercised by the employer over Mr. Younis to make this engagement a contract of service.

The Control Test

In days yonder, an employer exercises a great degree of control over his employee to teach, guide and closely scrutinize how, when and to what extent the given job has to be performed. However, this archaic method may not be applicable in today's advance society where it is not uncommon to find the majority of employees highly skilled and specialized in their respective area of expertise placing these in positions to advise and guide their own superiors and employers. And many employers have drunk bitter waters when they defied advices and guidance given by their own skilled employees.

But nevertheless this is still relevant to establish distinguishing elements between the two types of contracts. In the case of *Performing Right Society, Limited v. Mitchell and Booker (Palais de Danse), Limited*[3] *it was said "An independent contractor is one who undertakes to produce a given result, but so that in the actual execution of the work he is not under the order or control of the person for whom he does it, and may use his own discretion in things not specified beforehand."* Whereas this cannot be said so of a contract of service where considerable degree of control is often exercised by the employer over the employee.

However, this may not be an ideal test to decide the said distinguishing factor and that is why in the case of **Short v Henderson Ltd (1946**) the Court relied on another more effective benchmark called the Integration Test.

Integration Test

The 'integration test' is a benchmark to distinguish whether or not a worker is incorporated in the organization or if the work is part and parcel of the company.

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[3] ***lawmentor.co.uk:*** *The Control Test had it's origins in the* ***Master and Servant Law****. The nature of the test being that the issue of whether the tortfeasor was an employee was dependant on 'the nature and degree of detailed control.....'* ***Performing Right Society, Limited v. Mitchell and Booker (Palais de Danse), Limited. (1924).*** *In the case of* ***Performing Rights Society v Mitchell & Booker Ltd (1924)*** *the defendants were sued for the breach of copyright by a jazz band. The defendant occupied a dance-hall and had agreed in writing for a band to play at the hall as long as it did not infringe any copyright in the music it chose to perform. Unfortunately they chose to play some music, but did not have the plaintiff's permission. The plaintiff decided to sue the defendant looking to hold them responsible for the actions of the band. However the defendant's liability depended on the band being its employee. The court looked at the facts that regular hours where worked each day by the band, there was a fixed period of employment, the band had been told where they should work, and they had exclusivity of service, there was also a right to summarily dismiss the band for the breach of any reasonable instructions or requirement. The band was held to be an employee. In short the court looked at the 'nature and degree of detailed control over the person alleged to be a servant'.*

In Stevenson, Jordan and Harrison Limited v MacDonald and Evans, a case on copyright, Denning LJ said that: [4]
"[This case] raises the troublesome question of the distinction between a contract of service and a contract for services. The test usually applied is whether the employer has the right to control the manner of doing the work . . .
It is often easy to recognise a contract of service when you see it, but difficult to say wherein the distinction lies... One feature which seems to run through the instances is that, under a contract of service, a man is employed as part of the business, and his work is done as an integral part of the business; whereas, under a contract for services, his work, although done for the business, is not integrated into it but is only accessory to it"'
Lord Denning gave the illustrative comparison between the captain of a ship (an employee of the shipowners) and the pilot who boards the ship only to take it safely into harbour (an essential service but not one which makes the pilot an integral part of the shipowners' business).
Unfortunately most situations where the status of the worker is an issue do not provide such clear cut differences. As a result the 'integration test' has not played a large part in the evolution of the law on this matter.

The test was employed by Wan Suleiman FJ in *Employees Provident Fund Board v MS Ally & Co Ltd*.[5] In this case, the Federal Court found that working assistants who conducted and managed the business of M S Ally & Co Ltd and were rewarded by a share of the profits were employees of M S Ally as, inter alia, there was a sufficiency of control over the working assistants.

The multiple tests

Now, this would be a more realistic test where whether a service so rendered is indeed an employment contract of service or whether it is a commercial contract for service. Here, it is determined whether for services so rendered;
A payment for professional fees or charge is made or a wage / salary is paid
As to whether any reasonable control is exercised by the employer in consistent with what is exercised in a contract of service.
And by looking at the whole terms of the contract whether there are implied terms which could be read into the said contract to establish it being in consistent with that of a contract of service, since for an employment contract implied terms could be read into it.
For example, let us take a look at the following case:
Case Law: Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance. [6]
Point at issue
Whether an owner-driver of a vehicle used exclusively for the delivery of a company's ready mixed concrete was engaged under a contract of service or a contract for services.
Facts
Ready Mixed Concrete (South East) Ltd ("RMC") was in the business of making and selling ready mixed concrete. The company had engaged an independent haulage contractor to deliver the concrete to customers but that contract was terminated and RMC decided to introduce a scheme whereby concrete was delivered by owner- drivers working under written contracts. The owner-drivers entered into a hire purchase agreement with Readymix Finance Ltd to purchase a lorry but the mixing equipment on the lorry was the company's property. In 1965 the company asked the Minister of Social Security for a determination of the employment status of one of the owner-drivers, Mr Latimer.

Mr Latimer's written contractual terms included the following
he was entitled with the consent of the company to appoint a competent and suitably qualified driver to operate the truck in his place but this was subject to the company's entitlement to require him to drive the truck himself unless he had a valid reason for not doing so
he was responsible for paying any substitute
he had to wear a company uniform
he had to carry out all reasonable orders from any competent servant of the company
he had to maintain the lorry at his own expense and pay its running costs

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[4] *[1952] 1 TLR 101*

[5] *[1975] 2 MLJ 89*

[6] *[1968] 2QB497*

there was a mutual intention that Mr Latimer was an independent contractor.
Other facts found were
he did not work set hours and had no fixed meal break
the company did not tell him how to drive the truck or what routes to take
the nine owner-drivers in the depot arranged the dates of their own holidays to ensure that only one driver was away at any time and between them. They engaged a relief driver contributing equally to his weekly wage of £25.
during the busy season the company engaged three or four additional drivers under contracts of service.
Decision
The Minister decided that Mr Latimer was employed under a contract of service but, on appeal to the High Court, MacKenna J held that he was running a business of his own. In summing up MacKenna J said that Mr Latimer was a "small business man" and not a servant. He concluded that the contract was not one of service but of carriage.
Commentary
In his judgment, MacKenna J considered what is meant by a contract of service. He said
"A contract of service exists if these three conditions are fulfilled.

(i) The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master. (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master. (iii) The other provisions of the contract are consistent with its being a contract of service.

As to (i). There must be a wage or other remuneration. Otherwise there will be no consideration, and without consideration no contract of any kind. The servant must be obliged to provide his own work and skill. Freedom to do a job by one's own hands or by another's is inconsistent with a contract of service, though a limited or occasional power of delegation may not be…."
This established that in order for there to be a contract of service there must be
The worker has to be subject to a right of control. If there is no right of control of any kind then you will not have a contract of service. However, it was also made clear in the judgment that, although a right of control is an important factor in determining employment status, it is not necessarily a determining factor;
Personal service must be given. However, the court did make the important point that a limited right of delegation was not inconsistent with a contract of service. This has been reaffirmed by later case law (see ESM7220); and
the other factors present are consistent with a contract of service. Factors such as ownership of significant assets, financial risk and the opportunity to profit are not consistent with a contract of service.

Under Malaysian perspective, as to whether statutory remittances of EPF, SOCSO, HRDF and PCB are made by the employer so engaging his service. If the answer is in the affirmative, then his contract is being in consistent with that of an employment contract of service. If the answer is negative, then it could be easily deduced that it is a commercial contract for services.