Submission on Independent Contracting and Labour Hire

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This submission has been prepared for two purposes:

- for the House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation, in relation to its Inquiry into Independent Contractors and Labour Hire Arrangements;

- as a response to the Federal Government's Discussion Paper, *Proposals for Legislative Reforms in Independent Contracting and Labour Hire Arrangements*.

The submission is based not only on academic research,[1] but on my experiences as a consultant to a national law firm that advises and acts for businesses. It incorporates material originally presented in submissions to the Cole Royal Commission into the Building and Construction Industry, and before that to the Stevens and Stanley Reviews as to (respectively) industrial and workers compensation legislation in South Australia.

Some Fundamental Propositions

The submission proceeds from a number of basic premises:

1. *There is a fundamental distinction between being an employee and an independent contractor*. The essential difference is that an employee works for someone else, while an independent contractor operates their own business. It is a distinction that almost everyone in the community understands. It has also been recognised by the Australian courts, at least as a matter of principle. It is true that there is no "bright line" between the two categories. There are genuinely difficult cases in which it is hard to say into which category a person should be considered to fall. One example is the skilled professional such as the freelance journalist or film technician who may provide services to a wide variety of clients within a short period of time, and hence looks to be running a business, yet who has few if any business assets and no identifiable business name or identity. But this grey area is nowhere near as large as some make out. The overwhelming majority of working people are as a matter of practical reality quite firmly in one category or the other — and for the most part they are employees, at least in functional terms.

2. *In a democratic capitalist system, every person should have the freedom to choose to operate their own business rather than working for someone else.* To be in business is to be an entrepreneur. The entrepreneur risks whatever capital they

1 See especially Stewart, "Redefining Employment? Meeting the Challenge of Contract and Agency Labour" (2002) 15 *Australian Journal of Labour Law* 235 and the sources cited therein.

have been able to accumulate in a bid to profit from their venture. They may earn a little or a lot, or indeed they may lose money. Within whatever constraints are imposed by the need to raise finance and/or the conditions of the relevant product market, the entrepreneur makes their own decisions as to how the business is to operate and who is to perform the work. Those decisions may at times be severely limited, as for example with franchisees operating within a tightly controlled system. But the concepts of (relative) autonomy and risk-taking remains central. Contrast this with the employed worker, who generally works on the basis that some remuneration at least will be received for their efforts (even if the precise amount may be uncertain), and who is also aware that someone else is ultimately responsible for making the decisions that will determine whether they continue to be given a chance to earn that remuneration.

3. *If a person does work as an employee, they are entitled to the benefit of laws established for their protection*. In every democratic system there are laws that entitle employees to the benefit of minimum working conditions, that permit them to combine in unions to promote their collective interests, and that allow them to challenge arbitrary or unfair decisions by their employers that threaten their capacity to earn a livelihood. Those laws are premised on a recognition that most workers in most situations are at a fundamental disadvantage when dealing on an individual basis with an employer. In most cases (though not always) they lack the skills, information or available alternatives that would enable them to negotiate freely. This recognition does not dictate how much protection employees should receive, or what kind of laws and processes should be established. It does not mean that there cannot or should not be a role for individual contracting. It merely requires that there be *some* degree of intervention by the state to guard against some of the anti-social outcomes that can be expected from an unregulated labour market, which may include excessively low wages, excessively high working hours, dangerous working conditions, discriminatory treatment, and so on. Such intervention can be justified as promoting efficiency and productivity in the labour market,[2] quite apart from the more obvious appeals to equity and social justice.

4. *Whether a person is working as an employee or is considered to be running their own business should be determined as a matter of substance rather than form.* This should be regarded as self-evident. If the integrity of employment laws are to be protected, they must be applied without regard to the form in which an arrangement for the provision of labour is clothed. Just because someone is *called* a contractor should not dictate that they be treated for legal purposes as such — especially when the label has effectively been applied by a "client" firm that (a) stands to benefit from the lower labour costs associated with hiring someone as a non-employee, and (b) is in a position to dictate the terms of the arrangement.

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2 See eg Deakin & Wilkinson, "Labour Law and Economic Theory: A Reappraisal" in Collins, Davies & Rideout (eds), *Legal Regulation of the Employment Relation*, 2000; Collins, "Regulating the Employment Relation for Competitiveness" (2001) 30 *Industrial Law Journal* 17.

5. *It is common for Australian firms to seek to obtain labour from "dependent contractors" who are in effect disguised employees.*[3] By engaging a contractor, a firm may be spared the cost of providing leave and superannuation entitlements, of observing any award obligations, and perhaps too of insuring against work-related injury. They may also be relieved of any exposure to unfair dismissal claims or severance pay in the event of terminating the arrangement, and a contractor is far less likely to belong to a trade union. Even if higher nominal pay is provided than would be the case for an employee performing the same work, the firm is likely to end up ahead. Now if the contractor is genuinely running their own business, the firm may have to accept certain trade-offs: that the firm will have less control over who does the work, that the contractor may be preoccupied by other clients, and so on. But if the firm can find a way to hire someone who in practical terms works only for the firm and is under its (more or less) complete control, yet who is legally characterised as a contractor, the firm has the best of both worlds.

6. *Some workers genuinely want to have the "freedom" of working as a contractor, even if they are not in truth running a business.* For such workers, this may seem a rational choice (and occasionally it is). They may be able to earn higher rates of pay than if they were an employee, and also obtain tax deductions for a much broader range of expenses (assuming the PSI provisions discussed later on either do not apply, or are not enforced). If they remain healthy, they may not miss the absence of sick leave or insurance against work injury. They may not care about what happens to them in retirement. And psychologically, they may feel better about work if they perceive themselves to have "independent" status, even if in practical terms they have little real autonomy.[4]

7. *Nevertheless, it should not be lawful to agree (whether freely or not) to provide services as a contractor when in functional terms the person should be treated as an employee.* There are two fundamental reasons why it should not be possible for a person to "choose" to work as a contractor without genuinely operating an independent business. The first is that in many (though not all) instances the choice will simply not be free or unfettered, but rather the product of superior bargaining power on the part of the hirer. A courier, cleaner or security guard who is told they must accept contractor status if they are to be given work is hardly exercising a free choice. But even if the choice is genuinely made, there must nonetheless be limits to freedom of contract. We do not generally allow consumers to contract out of laws enacted for their protection, so why should we

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3 According to Waite and Will, "dependent contractors" (that is, contractors who are essentially tied to working for a single client) make up at least a quarter of all "self-employed" contractors, who in turn comprise at least 10% of the workforce: *Self-Employed Contractors in Australia: Incidence and Characteristics*, Productivity Commission Staff Research Paper, 2001. Not all dependent contractors are likely to be disguised employees, since it is clearly possible for some genuine businesses to work for a single client at a time, and indeed for lengthy periods. Nevertheless, the statistic gives some idea of the scale of the phenomenon.

4 See eg the views of owner-drivers noted in *Report of Inquiry into Owner Drivers and Forestry Contractors*, Industrial Relations Victoria, 2005, vol 1, p 99.

allow workers to do so? It is illegal for an employee to agree to work on the basis that they receive less than award wages, or no superannuation or annual leave. So why should it be lawful to achieve some or all of those outcomes by contriving a worker to appear to be a contractor, even if the worker acquiesces?

8. *The common law tests used in Australia for identifying an employee are defective in so far as they may be manipulated to produce a finding that a person is a contractor, when in functional terms they are working as an employee.* This is explained in more detail below. I go on to explain why I believe that what is needed in Australia is a stronger and more functional approach to determining employment status.

The Common Law "Definition" of Employment

Over the past century the common law conception of employment has come to act as the primary trigger for various forms of regulation. That conception requires or assumes the existence of a contract of employment (or contract of service) between a person who pays for work to be performed and a person who is to perform that work. As such, it excludes a range of work relationships which either (a) are not contractual in nature at all, as where work is performed voluntarily or for purely domestic purposes; (b) do not involve a contract directly between the parties; or (c) involve a contractual relationship which is characterised as something other than a contract of employment, as where the worker is said to be an "independent contractor" engaged pursuant to a "contract for services".

Not only is the common law conception of employment explicitly adopted by some statutes,[5] but for many years now terms such as "employee", "servant" and even "worker" (despite the more generic sense in which it is used in this submission) have all, when included in legislation and not otherwise defined, come to signify a person working under a contract of employment, rather than under some other kind of arrangement.

The consequence is that, as a general rule, those who would not be regarded as employees at common law may not have their remuneration or other working conditions regulated by an award or registered enterprise agreement, are not covered by minimum standards on leave entitlements, and may not bring unfair dismissal claims.

The common law principles for distinguishing between an employee and a contractor are set out in High Court decisions such as *Stevens v Brodribb Sawmilling Co Pty Ltd*.[6] These principles do not embody a "definition" of employment as such. They rely instead on a test which involves the consideration of a number of established factors or indicia, some of which are characteristic of a contract of service and others of

5 See eg the definition of "contract of employment" in s 4(1) of the *Industrial and Employee Relations Act* 1994 (SA) (soon to be renamed the *Fair Work Act* 1994).

6 (1986) 160 CLR 16.

which suggest a non-employment relationship.[7] The task of the court or tribunal which must assess the employment status of a worker is to consider the parties' relationship in light of each of these indicia and to determine, on balance, into which legal category the relationship falls. The approach is necessarily impressionistic, since there is no universally accepted understanding of how many indicia, or what combination of indicia, must point towards a contract of service before the worker can be characterised as an employee. In effect, this "multi-factor" test proceeds on the assumption that the courts will know an employment contract when they see it.

Importantly too, though this is rarely acknowledged, the application of the test can often depend on the adjudicator's starting-point. If a judge (whether consciously or subconsciously) starts with the assumption that a relationship is one of employment, and looks for factors that suggest otherwise, they may well reach a different conclusion to one who proceeds from the opposite direction. It is this, more than anything else, which I believe explains how the same facts can be viewed so differently by judges apparently asking the same questions and applying the same basic principles.[8]

Disguising Employees as Contractors

It is sometimes claimed that in applying the common law test, courts look to the "totality" or "substance" of the relationship under scrutiny. It is certainly true that where an engagement is not comprehensively recorded in writing, the courts will look to the parties' actual dealings so as to determine what has been agreed.[9] Furthermore the courts have been at pains to emphasise that the label attached by the parties to their relationship cannot be determinative of its legal characterisation.[10]

The reality though is that any competent lawyer can take almost any form of employment relationship and reconstruct it as something that the common law would treat as a relationship between principal and contractor (or contractor and sub-contractor), thereby avoiding the effect of much industrial legislation. Establishing or reviewing the terms for such arrangements is routine work in any commercial practice.

There are two basic ways to achieve the desired objective. The first is to prepare a written contract for the parties to sign which has as many indications as possible of a

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7 For a useful list, see *Abdalla v Viewdaze Pty Ltd* (2003) 122 IR 215 at 229–31.

8 Any number of examples could be given, but see eg the differences of opinion between trial judges and appeal courts in cases such as *Vabu Pty Ltd v Commissioner of Taxation* (1996) 81 IR 150 (couriers ultimately found to be contractors) and *Commissioner of State Taxation v Roy Morgan Research Centre Pty Ltd* [2004] SASC 288 (17/9/04) (market research interviewers ultimately found to be employees).

9 See eg *Hollis v Vabu Pty Ltd* (2001) 207 CLR 21.

10 See *Cam & Sons Pty Ltd v Sargent* (1940) 14 ALJR 163; *Narich v Commissioner of Pay-roll Tax (NSW)* (1983) 50 ALR 417; *Hollis v Vabu Pty Ltd* (2001) 207 CLR 21 at 45. Note, however, that the parties' expressed intention or understanding as to the nature of their relationship may be allowed to tip the balance where the court is otherwise in doubt: *Australian Mutual Provident Society Ltd v Chaplin* (1978) 18 ALR 385 at 389–90.

contract for services: payment by results rather than a regular wage, the requirement to supply an ABN and tax invoice when claiming payment, a notional freedom to work for other "clients", denial of leave entitlements, supply by the worker of their own tools or equipment, a requirement to self-insure against injury — and most importantly, if at all possible, a notional power to delegate or sub-contract tasks to other workers, a feature the courts have generally treated as incompatible with an employment relationship.[11]

In recent years some courts and tribunals have perhaps displayed a greater willingness to look at the substance rather than form of working relationships, and to find an employment relationship to exist despite the parties having attached the label of a contract for services. In *Hollis v Vabu Pty Ltd*,[12] for example, the High Court found that certain couriers were employees, despite being required to supply and maintain their own bicycles and vehicles and being paid according to the number of successful deliveries rather than on an hourly or weekly rate of pay. In reaching this conclusion, the Court noted that "viewed as a practical matter, the bicycle couriers were not running their own business or enterprise, nor did they have independence in the conduct of their operations".[13]

However it is important to appreciate that the contracts considered in this case and others like it were not as carefully constructed as they might have been. Lawyers who are asked to prepare contracts for services that will stand up to judicial scrutiny can still feel confident of being able to do so, especially if they use a delegation clause. A string of decisions since *Hollis v Vabu* attests to this.[14] Each of these cases featured workers who were providing services exclusively to a single "client", under terms dictated by that client, and with little or no control over the amount of their remuneration or working hours. Yet they were determined to be contractors who were supposedly operating a business, simply because the judges concerned were not prepared to look past a well drafted contract and consider the reality of the arrangement.[15] It really *is* possible, despite what some judges say, to "create

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11 See *Australian Mutual Provident Society v Chaplin* (1978) 18 ALR 385 at 391; *Stevens v Brodribb Sawmilling Co Pty Ltd* (1986) 160 CLR 16 at 26, 38; *Australian Air Express Pty Ltd v Langford* [2005] NSWCA 96 (4/4/05). Note however that a limited or occasional power of delegation may not prevent a contract being held to be one of service: see eg *Sammartino v Mayne Nickless* (2000) 98 IR 168 at 210.

12 (2001) 207 CLR 21.

13 (2001) 207 CLR 21 at 41. See also *Commissioner of State Taxation v Roy Morgan Research Centre Pty Ltd* [2004] SASC 288 (17/9/04) (market research interviewers).

14 See eg *Belcaro v Sheahan* (2002) 116 IR 240 (security guard); *Thompson v Cooee Point Abattoirs Pty Ltd* (2002) 10 Tas R 412 (slaughterman); *Personnel Contracting Pty Ltd v CFMEU* [2004] WASCA 312 (22/12/04) (building workers); *Australian Air Express Pty Ltd v Langford* [2005] NSWCA 96 (4/4/05) (owner/driver).

15 For other unrealistic findings of independent contractor status, even in the absence of a carefully drafted contract, see *Donatacci v Czapp Pty Ltd* (2004) 135 IR 219 (garage door serviceman/installer); *Paddison v Ultimate Image Pty Ltd* [2004] NSWCA 410 (17/11/04) (plasterer); *National Transport Insurance Ltd v Chalker* [2005] NSWCA 62 (15/3/05) (driver/operator of prime mover).

something which has every feature of a rooster, but call it a duck and insist that everybody else recognise it as a duck".[16]

The second and even surer method of avoiding an employment relationship is to interpose some form of legal entity between the worker and the client business, since in the absence of a direct contract between the two there cannot be an employment relationship.[17] Leaving aside the use of a labour hire agency (of which more is said below), that entity might be a personal company, or a partnership constructed for the purpose between two or more workers, or some kind of family trust. Whether or not the worker is technically an employee of the interposed entity, they cannot and will not be an employee of the ultimate user of their services.

In a purely legal sense there is nothing "illegitimate" about either of these arrangements (the carefully drafted contract for services or the use of interposed entity). As the law stands it is quite lawful to set out about creating a relationship that is not one of employment. They are not "shams", in the very strict sense of that legal term. It is only a sham when parties construct what they would both understand to be an employment relationship and *then* try and disguise it as something else by adopting an arrangement that does not genuinely reflect their intentions.[18]

Nonetheless, for the reasons advanced at the beginning of this submission, it should *not* be lawful to contract out of labour regulation by exploiting these possibilities. As mentioned below, governments have moved to protect their revenue streams by cracking down (even if only partially) on disguised employment arrangements. Logic and fairness demand that the same action be taken to protect the integrity of our labour laws.

Possible Solutions

Various approaches can be and have been adopted by legislators to bring "employment-like" arrangements within the scope of particular regulation. There is for example a long established tradition of "deeming" workers in various occupations to be employees for specific purposes, or at least of clarifying that they are employees where doubt might otherwise exist on that score.[19] But relying on such provisions to stem the tide of disguised employment arrangements has two key drawbacks. In the

16 Cf *Re Porter* (1989) 34 IR 179 at 184.

17 See eg *Climaze Holdings Pty Ltd v Dyson* (1995) 58 IR 260; *Richtsteiger v Century Geophysical Corp (No 3)* (1996) 70 IR 236; *Blake v Sitefate Pty Ltd* (1997) 74 IR 466. It is conventionally assumed that a legal entity other than a natural individual cannot be an employee: see eg *Australian Mutual Provident Society Ltd v Chaplin* (1978) 18 ALR 385 at 391–2.

18 For a rare example of this being found to be the case, see *Hartnett v Aardvark Security Services Pty Ltd* (1998) 85 IR 315.

19 For a general account of deeming provisions in Australia and their rationale, see Clayton & Mitchell, *Study on Employment Situations and Worker Protection in Australia: A Report to the International Labour Office*, Centre for Employment and Labour Relations Law, University of Melbourne, 1999.

first place, it is usually a reactive strategy, relying on someone to identify a particular class of workers and take steps to invoke the relevant deeming mechanism. Secondly, deeming provisions are generally directed at the status of a class of workers and do not address the reality that *any* individual worker, no matter what their job, can readily be converted into what the common law would regard as a non-employee.

The same objections can be levelled at the provisions which now empower the Queensland Industrial Relations Commission to deem certain classes of worker to be employees,[20] even though they have the advantage of allowing action to be taken without the need to wait for statutory amendments or the promulgation of regulations.

A more effective and generally applicable form of deeming provision can be found in some State payroll tax statutes, under which contractors are treated as employees, even when working through a personal company, when they perform all the relevant work personally and do not in practice engage anyone else to assist them.[21] The same legislation also deems labour hire agencies to be the employers of any workers whose services they hire out.[22] The greatest drawback with these provisions is their drafting, which is so convoluted that only the most dedicated of lawyers can make sense of them — and even then the full extent of their application is far from clear.[23]

By contrast to the payroll tax legislation, s 12(3) of the *Superannuation Guarantee (Administration) Act* 1992 contains a much simpler provision, obliging employers to make superannuation contributions not only in relation to employees, but also those working under any contract that is "wholly or principally for the labour of the person to whom the payments are made". In interpreting this formula, however, the courts have held that a contract for services falls outside its scope if the principal aim of the contract is to "produce a given result".[24] Since virtually every contract to provide labour can be so characterised, especially if the contract is drawn up in the right way, the interpretation has robbed the provisions in question of any effective content.

Changes to the tax system have also made some difference. In particular, the personal services income (PS) legislation[25] has reduced the tax incentives for some workers to agree to be hired as an independent contractor rather than as an employee, or to operate through an interposed entity such as a personal company, partnership or family trust. However these provisions do *not* deem such a worker to be an employee,

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20 *Industrial Relations Act* 1999 (Qld) s 275. In practice, this provision has scarcely been used, although see *ALHMWU v Bark Australia Pty* [2001] QIRComm 22 (28/2/01).

21 See eg *Pay-roll Tax Act* 1971 (NSW) s 3A; *Pay-Roll Tax Act* 1971 (Vic) s 3C. In Victoria, similar provisions appear in ss 8 and 9 of the *Accident Compensation Act* 1985.

22 See eg *Accident Compensation Commission v Odco Pty Ltd* (1990) 64 ALJR 606.

23 This is amply illustrated by the first part of the judgment of Phillips JA in *Drake Personnel Ltd v Commissioner of State Revenue* (2000) 2 VR 635.

24 *Neale v Atlas Products (Vic) Pty Ltd* (1955) 94 CLR 419; *World Book (Australia) Pty Ltd v Commissioner of Taxation* (1992) 27 NSWLR 377; *Vabu Pty Ltd v Commissioner of Taxation* (1996) 81 IR 150.

25 *Income Tax Assessment Act* 1997 (Cth) Divs 84–87, as originally introduced by the *New Business Tax System (Alienation of Personal Services Income) Act* 2000.

nor in any way affect the incentives for businesses to persuade workers to contract in this way. Moreover it is far from clear that these provisions are being stringently enforced by the ATO, which of necessity allows many contractors to self-assess rather than be subjected to detailed scrutiny.[26]

Similarly, legislation in some jurisdictions (New South Wales, Queensland, and to a lesser extent the Commonwealth) may permit workers who are categorised by the law as contractors to complain about the fairness of their work arrangements.[27] These can be used by or on behalf of contractors to complain about receiving remuneration that would be less than an employee would get for doing the same work, or indeed to argue that the very purpose of engagement as a contractor was to take the worker outside the scope of the award system. Yet there have been few examples of such applications in recent years.[28] The explanation doubtless lies in the fact that the onus is placed on individual workers to lodge a complaint. Especially for those who are unable or unwilling to turn to a union for support, this will often be asking too much, at least while the relationship remains on foot.

These various forms of regulation represent piecemeal responses. A more effective approach, it is suggested, is to tackle the problem at source — the common law "definition" of employment itself. What is needed is adopt a standard or model definition of employment that can be included in any legislation where it is considered necessary to apply obligations or extend entitlements to or in respect of those who work for someone else in a subordinate and dependent capacity, but not those who are genuinely in business in their own account. The aim of such a definition would be to draw a more realistic boundary than the common law test has done between those two categories, and to reduce the ease with which hirers can presently disguise employment arrangements.

It is not suggested that the definition should be *universal*. There will always be a case for saying that certain kinds of law — for example, discrimination legislation — should apply to all arrangements for the performance of work, whether by employees or entrepreneurs. And even where a law is generally applicable to employees, there may still be a convincing policy argument as to why a particular type of worker should or should not be covered, as with some of the deeming or exclusionary provisions found in workers compensation legislation.

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26 For example, the Micro-Businesses section of the ATO's *Compliance Program 2004–05* (available at www.ato.gov.au) records an intention to "review around 400 arrangements that may involve alienation of personal services income". That is a significant number, but nonetheless a tiny fraction of the total number of cases that might potentially be regarded as questionable.

27 *Industrial Relations Act* 1996 (NSW) s 106; *Industrial Relations Act* 1999 (Qld) s 276; *Workplace Relations Act* 1996 (Cth) ss 127A–127C.

28 For exceptions, see eg *Buchmueller v Allied Express Transport Pty Ltd* (1999) 88 IR 465; *Massart v Kentlands Pty Ltd* [2001] QIRComm 221 (4/12/01); *Sisley v Ellenberger* [2004] NSWIRComm 341 (19/11/04).

But for all that, there is still considerable value in striving for a definition of employment that can be used in as many contexts as possible, so as to reduce the degree of uncertainty generated by the present patchwork of deeming provisions. There have been frequent calls from business groups for greater harmonisation of laws in this area. The time has surely come to respond to those calls, even if we can expect disagreement as to what a standard definition should look like.

A Proposed Redefinition of Employment

The following standard definition of employment is proposed:[29]

> *(1) A person (the worker) who contracts to supply their labour to another is to be presumed to do so as an employee, unless it can be shown that the other party is a client or customer of a business genuinely carried on by the worker.*
>
> *(2) A contract is not to be regarded as one other than for the supply of labour merely because:*
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> *(a) the contract permits the work in question to be delegated or sub-contracted to others; or*
>
> *(b) the contract is also for the supply of the use of an asset or for the production of goods for sale; or*
>
> *(c) the labour is to be used to achieve a particular result .*
>
> *(3) In determining whether a worker is genuinely carrying on a business, regard should be had to the following factors:*
>
> *(a) the extent of the control exercised over the worker by the other party;*
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> *(b) the extent to which the worker is integrated into, or represented to the public as part of, the other party's business or organisation;*
>
> *(c) the degree to which the worker is or is not economically dependent on the other party;*
>
> *(d) whether the worker actually engages others to assist in providing the relevant labour;*
>
> *(e) whether the worker has business premises (in the sense used in the personal services income legislation); and*

29 Note that the proposed redefinition differs from versions I have previously put forward, though only in the detail of para (2).

(f) whether the worker has performed work for two or more unrelated clients in the past year, as a result of the worker advertising their services to the public.

(4) Courts are to have regard for this purpose to:

(a) the practical reality of each relationship, and not merely the formally agreed terms; and

(b) the objects of the statutory provisions in respect to which it is necessary to determine the issue of employment status.

(5) An employment agency[30] which contracts to supply the labour of a person (the worker) to another party (the client) is to be deemed to be that person's employer, except where this results in a direct contract between the worker and the client.

(6) Where:

(a) an arrangement is made to supply the labour of a person (the worker) to another party (the ultimate employer) through a contract or chain of contracts involving another entity (the intermediary), and

(b) it cannot be shown that the intermediary is genuinely carrying on a business in relation to that labour that is independent of the ultimate employer, on the basis of factors similar to those set out in (3) above,

the worker is to be deemed to be the employee of the ultimate employer.

As far as contracts directly between "employers" and individual workers are concerned, the keys to this proposal are (a) to put the onus on a person who wishes to deny that a relationship is one of employment to show that the worker concerned is genuinely carrying on a business; and (b) to set out certain factors to which regard should or should not be had for that purpose.

Of the factors listed in paragraph (3) above, the relevance of most should be fairly self-evident. The references to the "practical reality" of the relationship and to the degree of "economic dependence" are intended to reflect the approach adopted by Gray J in *Re Porter*.[31] That case, in which a group of owner-drivers were found to be employees, is one of the rare instances at common law of a judge genuinely focusing on the substance of a relationship rather than the contractual terms used to describe and regulate it.

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30 That is, an entity whose business involves or includes the supply of workers to other unrelated businesses or organisations, whether through a contract or a chain of contracts.

31 (1989) 34 IR 179 at 184–185.

The list also draws on three of the four tests adopted in the PSI legislation (the employment, unrelated clients and business premises tests). However it makes no reference to the proportion of income generated from any one source over the previous year (ie, it does not pick up the "80/20 rule"), so as to avoid having the employment status of a worker potentially vary depending on when the question is asked, and indeed so as to simplify the process of inquiry.

If the PSI legislation were tightened up, in particular by removing the results test and some of the qualifications on what is treated as personal services income,[32] and possibly also by requiring at least two out of the three remaining tests to be satisfied, there might be scope for linking the determination of employment status more strongly with that regime. For example, it might be provided that where a worker or entity had obtained a personal services business determination from the Commissioner of Taxation, and there had been no subsequent change in relevant circumstances, the onus of proof would be reversed: the person would now be presumed to be a contractor unless there were clear indications to the contrary. Seeking such a determination would become a readily available method of lessening doubt as to the application (or non-application) of various labour laws. But there would be difficulties in making the determination conclusively binding, at least in relation to federal matters, since under Chapter III of the Constitution the judicial power of the Commonwealth may only be vested in a court composed of judges with tenured appointments.[33]

As things stand, however, the PSI legislation has too many loopholes to be used for this purpose. It is capable of conferring business status on the likes of owner-drivers, outworkers in the clothing trades industry, computer programmers, and a wide range of other workers (and/or their personal companies), even where those workers are wholly dependent on a single client and do not employ others.

For that reason, paragraph (6) of the proposal seeks to address the use of interposed entities (other than employment agencies[34]), not by extending the personal services income provisions and giving them effect in relation to employment status as well as taxation of income, but by simply disregarding them where the "genuine business" test cannot be satisfied. Hence where a personal company or family trust has only a single person performing the relevant work, and is economically dependent on a single client, it would be expected that the worker behind the company would be treated as the client's employee, just as if they had contracted directly.

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32 Notably that income will not be treated as deriving from personal services where the primary purpose of an arrangement is to supply the use of an asset, or to produce goods for sale, and the supply of a worker's labour is considered merely to be an incidental feature of that arrangement.

33 See eg *Waterside Workers Federation of Australia v JW Alexander Ltd* (1918) 25 CLR 434; *Brandy v HREOC* (1995) 183 CLR 245.

34 Employment agencies would not be caught by paragraph (6) because although fitting the description of an intermediary, they are clearly operating a genuine business. Their position is discussed in more detail below.

The proposal in paragraph (6) should also catch the use of "service companies" which are controlled by but legally distinct from the operator of a business.[35] Although a service company would pass the "employment test", so long as it engaged more than one person, it would struggle to satisfy any of the other indicia of a genuinely independent business. Again, the effect would be to force the true business operator to assume the responsibility for employing their staff.

The Particular Issue of Labour Hire

In the standard labour hire situation, an agency enters into an agreement with a worker, and arranges to hire out their services to a host firm, or to a series of hosts. The worker is paid by the agency, which in turn charges each host a fee that covers the worker's remuneration and any associated on-costs.

The orthodox legal view is that, in the absence of any contract between the worker and the host, the worker cannot be regarded as an employee of the host. Such a contract will not be inferred merely because the host exercises what may be a considerable degree of day-to-day control over the worker.[36] There have been instances in which the agency and the host have not been sufficiently careful in establishing the necessary trilateral relationship, especially where the worker was originally an employee of the host and was then "transferred" to the agency. In such cases, courts have been prepared to hold that the worker remained in a contractual relationship with their original employer.[37] But these are the exceptions, rather than the rule. In most cases, agencies are careful to ensure that they alone have a contract with the worker.

It has sometimes been suggested that labour hire workers should be treated as "jointly employed" by the agencies that hire them out and the hosts for whom they work.[38] There may indeed be merit in certain contexts of allocating responsibility jointly between agency and host firm, for example in relation to the rehabilitation of injured workers.[39] However in relation to many other obligations, such as the provision of leave or the payment of superannuation contributions, the practical difficulties associated with giving the worker simultaneous rights against two separate and unrelated entities seem manifest. Similarly, while there may be some logic in *dividing* employer-related responsibilities between the agency and the host, according to the

35 See eg *Morgan v Kittochside Nominees Pty Ltd* (2002) 117 IR 152; *Muir Electrical Co Pty Ltd v Commissioner of State Revenue* (2001) 4 VR 70.

36 *BWIU v Odco Pty Ltd* (1991) 29 FCR 104; *Mason and Cox Pty Ltd v McCann* (1999) 74 SASR 438.

37 See eg *Damevski v Giudice* (2003) 202 ALR 494.

38 See eg *Morgan v Kittochside Nominees Pty Ltd* (2002) 117 IR 152 at [72]–[77]. Note also the proposal in the Industrial Law Reform (Fair Work) Bill 2004 (SA) to allow dismissed labour hire workers to bring a claim against both the agency that engaged them and the host firm at which they worked. The provisions in question did not secure parliamentary support and were omitted from the final version of the legislation.

39 See the recommendations to this effect by the NSW Labour Hire Task Force, *Final Report*, NSW Department of Industrial Relations, 2001, pp 66–7.

nature and purpose of the laws in question, it would seem simpler all round to leave the agency with the bulk of the obligations.

To insist that a host firm must be treated as an employer is in effect to challenge the very practice of labour hire. Unlike the use of some interposed entities such as personal companies, there are clearly reasons for engaging labour through an agency which may be perfectly legitimate and which cannot necessarily be treated as a device for evading labour laws — for example, obtaining temporary replacements for staff on leave. Labour hire is a well established feature of the modern labour market and should be accepted as such.

The question remains as to the status of the relationship between agency and worker. Most agencies, certainly the reputable ones, are content to operate on the basis that they have an employment relationship with the workers whom they hire out. They accept the legal responsibilities associated with an employer — albeit they frequently construct their relationships as casual in nature, thereby avoiding any liability to provide annual leave, severance payments and so on.

There are some agencies, though, that purport to engage their workers as contractors, insisting that they sign documents describing themselves as such. This is commonly known as an "Odco-style system", after the name of the company behind the Troubleshooters agency. In 1991 the Full Federal Court held that building workers supplied by this agency were not employed by it, not least because the agency exercised little or no control over their work when they were on site.[40] In the aftermath of this decision other agencies were inspired to adopt similar arrangements, sometimes indeed under "franchise" from Odco itself.

In recent years courts have been divided as to the status of such arrangements. Some have upheld the intent to create a contract for services.[41] But others have ruled that such agencies may still be employers, even in the absence of day-to-day control over their workers. In each instance, the court could see no meaningful basis for saying that the workers concerned were running their own businesses.[42] Once again, the difference between these decisions can only be explained by differing judicial philosophies. Those who upheld the Odco-style arrangements were prepared to take the contractual description at face value and give it weight. Those who took the opposite view were more likely to have regard to the substance of the arrangement: though it is worth emphasising that in none of the cases in which an employment relationship was found was the court confronted with a "foolproof" contract (ie, one

40 *BWIU v Odco Pty Ltd* (1991) 29 FCR 104.

41 See eg *AMIEU, Newcastle & Northern Branch v Australian Independent Contractors Agency* [2004] NSWIRComm 238 (19/8/04); *Personnel Contracting Pty Ltd v CFMEU* [2004] WASCA 312 (22/12/04).

42 See eg *Drake Personnel Ltd v Commissioner of State Revenue* (2000) 2 VR 635; *Country Metropolitan Agency Contracting Services Pty Ltd v Slater* (2003) 124 IR 293; *Staff Aid Services v Bianchi* (2004) 133 IR 29; *Forstaff v Chief Commissioner of State Revenue* [2004] NSWSC 573 (8/7/04); and see also *Damevski v Giudice* (2003) 202 ALR 494 at 504–5.

with an extensive delegation clause, and/or a requirement to operate through a personal company).

Impact of Proposed Redefinition on Labour Hire Agencies

Paragraph (5) of the proposal set out earlier in this submission seeks to settle the potential doubts surrounding the employment status of labour hire workers by firmly declaring them to be the employee of any agency that has agreed to supply their services to a client and that continues to pay them. This would not impinge on those agencies who are already prepared to employ the staff they hire out. It would only affect those who seek to exploit the reasoning in cases like *Odco*.

For host firms who currently use Odco-style agencies to obtain workers who are in substance employees, they would cease to reap the cost-savings associated with this form of evasion of employment entitlements. If a firm wished to engage a contractor who was genuinely running their own business, there would be nothing to stop them engaging that contractor directly. And if that firm wished to use a recruitment agency to identify appropriate persons to work for it, whether as employees or contractors, they could still do that as well. A recruitment agency that did not hire out labour on an ongoing basis would not be affected by what has been suggested.

The proposal would also leave undisturbed the principle that such staff are not employed by the host firm. It seems enough in this context that *someone* be identified as the employer — and the agency, as the entity that contracts with and pays the worker, is the more logical choice.

Conclusion on General Issues

The central arguments of this submission are that the time for tackling arrangements which are designed to evade the effect of labour laws is well and truly overdue, and that the most appropriate and effective way to do so is to reaffirm the basic distinction between being employed and being in business. Rather than simply give in to the growing tide of evasive arrangements, or add even further complexity to the existing patchwork of deeming provisions that apply in different contexts and at different times, a standard definition of employment should be adopted which (a) provides a more realistic basis than the common law has done for distinguishing between an employee and an entrepreneur, (b) requires all labour hire agencies to take on the responsibility of employing any staff they hire out, and (c) disregards other interposed entities such as personal companies where the “genuine business” test cannot be satisfied.

It can be expected that there will be objections to such a reform — and quite strident ones at that. Businesses benefiting from present arrangements will no doubt complain about a loss of flexibility, about increased cost, about an increase in government regulation, and so on. Lobby groups purporting to represent contractors will invoke the ideal of “freedom of contract”, emphasising the “liberating” effect of workers “choosing” to throw off the “shackles” of employment status.

But in the end, if firms wish to secure labour from a subordinate and dependent workforce, they should be prepared to bear the cost of the regulation that is associated with employing staff. To insist otherwise, and to maintain some "right" to contract out of employment entitlements through carefully structured arrangements, is not only to defeat the very purpose of that regulation but to obtain an unfair competitive advantage over businesses that employ their labour directly.

If the federal government believes (as it clearly does) that existing labour regulation is too "inflexible" or "restrictive", and that it imposes unnecessary costs on employers, then let it seek to amend or adjust that regulation. It should not be encouraging businesses to escape that regulation simply by drafting the right kind of contract.

Responses to Specific Questions or Proposals in the Discussion Paper

1. *The WR Act should be amended to provide that awards and agreements cannot contain clauses which restrict engaging independent contractors or impose conditions or limitations on their engagement.*

   No. As a Full Bench of the AIRC has recently confirmed, employees (and the unions that represent them) have a legitimate interest in any decision by their employer to obtain supplementary or replacement labour from workers who are not directly employed, because of the potential effect on their jobs or on the integrity of the terms established for their employment.[43] As matters stand, it is both legally and industrially acceptable for a firm to agree with its employees that such labour will only be engaged in particular circumstances or on particular terms.[44] There is no warrant for the legislature to intrude upon the freedom of employers and their employees to deal with this issue. If firms are prepared to agree on conditions for the use of contract or agency labour, as part of the compromises and trade-offs that mark every enterprise agreement, that is a choice that should be respected. As for the potential for award regulation, I am unaware of any evidence to suggest that restrictions on the use of outside labour is an extensive feature of current awards, or even where it is that the issue cannot be addressed through enterprise bargaining. The AIRC can and should be trusted to deal with every case on its merits and to apply the general principle, as demanded by the objects of the WR Act, that matters such as this should if possible be resolved by agreement.

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43 See *Re Rural City of Murray Bridge Nursing Employees, ANF (Aged Care) – Enterprise Agreement 2004* (AIRC, PR956575, 18/3/05) at [71]–[83], citing in particular observations by the High Court in *R v Moore; Ex parte Federated Miscellaneous Workers Union of Australia* (1978) 140 CLR 470.

44 Cf *R v Commonwealth Industrial Court; Ex parte Cocks* (1968) 121 CLR 313, holding that an outright prohibition on the use of contract labour is not a matter that can be regarded as directly "pertaining" to the employer-employee relationship and hence cannot be included in an award (or, by extension, a certified agreement).

2. *Should the current common law definitions of independent contractor and employee be retained for the purpose of the WR Act, with courts determining the question using established common law principles?*

   No. For the reasons already set out in the main part of this submission, the current definition of "employee" in s 4(1) of the WR Act should be replaced with a more extensive provision along the lines set out earlier. It would then be necessary to adopt a definition of "independent contractor" that clarified the intent to cover only persons who are not employees within the expanded sense of that term.

3. *Should the personal services business test under the Income Tax Assessment Act 1997 be adopted as the sole definition of "independent contractor" for the purposes of workplace relations regulation?*

   No. The test is unsuitable because, as previously explained, it has significant flaws (notably the "results test") and allows disguised employees who are not genuinely running a business to be classed as operating a "personal services business". By definition too, the "80/20" element in particular is constructed so as to assess a person's status over the course of a full financial year. Without modification, it cannot readily be used to determine a person's status at a single point of time (eg in determining eligibility to bring an unfair dismissal claim), or over a period that may span financial years (eg entitlement to a service-based entitlement such as long service or annual leave).

4. *Should the personal services business test under the Income Tax Assessment Act 1997 be adopted as part of the definition of "independent contractor" for the purposes of workplace relations regulation?*

   No, since there is no need for an extensive definition of "independent contractor". But elements of it could be used as part of a definition of "employee', as I have endeavoured to do in my own proposal.

5. *Should an "Independent Contracting Registrar" be established to make declarations about employee/independent contractor status applying the appropriate tests?*

   No. Aside from the drawbacks explored in the Discussion Paper, there would (for reasons previously explained) be constitutional problems with according binding force to a declaration given by such an official, unless the official had judicial status. There would also be the cost associated with establishing yet another bureaucracy (compare my earlier suggestion of giving limited status to personal services business determinations from the ATO, which at least draws on an existing process).

6. *Should an object be added to section 3 of the WR Act to the effect that the status of independent contractors should be upheld and subject to minimal industrial regulation?*

If this is code for encouraging courts and tribunals to rule workers to be contractors even when they have all the functional characteristics of employees and are not genuinely running their own businesses, then no. There would be no harm (though little practical purpose) in the legislation stating that, unless the contrary is clearly stated, the regulation established by the Act is intended only to apply to employment relationships.

7. *Are there any State laws other than workplace relations law (such as workers' compensation, anti-discrimination or OHS laws) containing independent contractor provisions which the Commonwealth should consider overriding?*

   In relation to anti-discrimination and OHS laws, no, since there are powerful arguments as to why safe working conditions and freedom from discriminatory treatment are objectives that should be pursued in relation to *all* arrangements for the provision of labour, with only very limited exceptions. As to workers compensation laws, there would be merit in the Commonwealth and the States working together to develop a common definition of "worker" that is broad enough to dispense with the need for the current patchwork of deeming provisions, and to agree on those limited cases where deeming provisions remain essential (for example, volunteer firefighters). But so long as the Commonwealth is prepared to leave workers compensation arrangements to the States, any attempt to interfere with State definitions would simply create unnecessary conflict and confusion.

8. *Should the proposed Independent Contractors Act override State and Territory unfair contract laws and seek to cover the field (as far as constitutionally possible) for unfair contract provisions?*

   There would be no harm in creating a consistent national system for the review of unfair contracts, *provided* the federal legislation were extended to cover arrangements with contractors who are not natural persons (cf s 4(1A) of the WR Act). It would also be sensible to return the unfair contracts jurisdiction to the AIRC, so as to lessen the costs involved for all concerned.[45] But this should not in any event be seen as a substitute for tackling the issue of disguised employment more directly.

9. *Should the Federal Magistrates Court be given jurisdiction to review contracts?*

   Failing the more preferable step of returning the jurisdiction to the AIRC, there would be some merit in conferring it on the FMC, *provided* magistrates with appropriate commercial and/or industrial experience were appointed to that court.

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45 As originally enacted in 1992, this jurisdiction was conferred on the AIRC, but it was transferred to the Industrial Relations Court in 1993 (and later the Federal Court) to meet what turned out to be unnecessary concerns that the powers involved were judicial in nature and thus could only be vested in a court: see *Re Dingjan; Ex parte Wagner* (1995) 183 CLR 323, upholding the original conferral of such powers on the AIRC.

10. *Should the proposed Act seek to override State "deeming provisions", which draw independent contractors into the net of workplace relations regulation, as far as constitutionally possible?*

    To repeat the point already made in relation to workers compensation laws, it would be preferable for the Commonwealth to work co-operatively with the States to develop a broader and more appropriate definition of employment that prevents workers being disguised as contractors when in functional terms they are really employees.

11. *Should a civil penalty provision be introduced in the WR Act applying to hirers who deliberately attempt to avoid employer responsibilities by seeking to establish a false independent contracting arrangement?*

    The Discussion Paper advances this suggestion in the context of dealing with "sham" arrangements. As already explained, the narrowness of the legal definition of such arrangements means that they are rare in practice. The point in any event should not be to "punish" firms, but to ensure that they meet their obligations as employers if they secure labour from persons who in functional terms are their employees.

12. *Should the labour hire industry be regulated to ensure high standards are met by all players?*

    I have no firm view on the matter, but given that many reputable agencies have supported the idea there seems merit in exploring the introduction of some kind of licensing system. Again though, this is of secondary importance to ensuring that agency workers are not arbitrarily denied the status of being an employee.

13. *The WR Act should be amended to provide that awards and agreements cannot contain clauses which restrict engaging labour hire workers or imposing conditions or limitations on their engagement.*

    No, for the reasons already explained in addressing proposal (1) above. There is no evidence in any event that workplace bargaining has had the effect of restricting the use of labour hire. Indeed according to researchers at the Productivity Commission, firms that engage in such bargaining are *more* likely to use labour hire; while for those firms already using labour hire, workplace bargaining has not affected the rate of use.[46]

14. *Should the WR Act be amended to include in the definition of "employer" a labour hire agency that arranges for an employee (who is a party to a contract of service with the agency) to do work for someone else even though the employee is working for the other party under a labour hire arrangement?*

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46 Laplagne, Glover & Fry, *The Growth of Labour Hire Employment in Australia*, Productivity Commission Staff Working Paper, 2005, p 17.

This would be a meaningless reform. It is already clear that an agency *can* be an employer. Hence there is no real need for provisions such as s 6(2)(d) of the *Industrial Relations Act* 1999 (Qld), which defines "employer" to include a "labour hire agency that arranges for an *employee* (who is party to a *contract of service* with the … agency) to do work for someone else" (emphasis added). The definition leaves it open for an agency to assert that its workers are contractors rather than employees, and hence achieves little other than to dispel a doubt that most commentators would say no longer exists.

15. *Should "Odco" arrangements be statutorily recognised in the Independent Contractors Act?*

    Absolutely not. Odco-style arrangements were originally conceived, and continue to be promoted, as a means of avoiding a finding of employment status. There is no legitimate reason for their use and they should accordingly be prohibited. To give them statutory recognition would be to send a powerful message that it is acceptable to disguise employment through a technicality, and to encourage reputable agencies to seek to compete by adopting similar systems. To repeat my earlier point, if a firm wants to secure services from a genuine contractor, what is there to stop that firm dealing directly with that contractor?

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