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Employment law update

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High Court closes loophole on independent contractors

Use of labour hire arrangement can amount to sham contracting

In a unanimous judgment, the High Court has ruled that employers cannot avoid the sham contracting provisions in the *Fair Work Act 2009* (Cth) ("**the FW Act**") through the use of third party labour hire arrangements.

In *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd*[1] the High Court overturned an earlier Full Federal Court decision and held that Quest South Perth Holdings Pty Ltd ("**Quest**") had breached the FW Act's sham contracting provisions when it misrepresented an Odco-style independent contractor arrangement.

WHAT IS THE ODCO SYSTEM?

The Odco system of contracting involves engaging workers on independent contractor agreements (contracts for services) via a third party so that there is no direct contractual relationship between the worker and the entity or person for whom they are performing the work.

This system of contract labour hire is widely licensed to labour hire agencies throughout Australia, who provide independent contractors to companies in an extensive range of industries.

SHAM CONTRACTING

Although since 1991 the courts have viewed the Odco system as legitimate, the FW Act's commencement in 2010 brought with it stricter "sham contracting" provisions which specifically prohibit an employer (or prospective employer) from (amongst other things) misrepresenting that a contract of employment is a contract for services (section 357(1) of the FW Act).

1 *[2015] HCA 45*

BACKGROUND IN *FAIR WORK OMBUDSMAN V QUEST SOUTH PERTH HOLDINGS PTY LTD*

Two housekeepers were originally employed by Quest in cleaning roles.

Quest entered into a contractual arrangement with Contracting Solutions Pty Ltd ("**Contracting Solutions**"). Pursuant to this arrangement, the housekeepers would cease to be Quest employees and subsequently be engaged by Contracting Solutions as independent contractors. Contracting Solutions would then provide the services of the housekeepers back to Quest under a labour hire arrangement.

Contracting Solutions met with Quest's housekeepers and provided them with a "sign up pack" which included a contractor application form. There were a number of representations made to them to encourage them to sign up and the benefits of "converting" to independent contractors.

The fact that the housekeepers would lose statutory employment entitlements upon becoming independent contractors was not discussed with them.

Importantly, at this meeting Quest represented to the housekeepers that "*upon accepting Contracting Solutions' proposal, they would continue to perform work at Quest but would do so as independent contractors of Contracting Solutions and not as employees of Quest*."

In reality, the housekeepers continued to perform exactly the same work at Quest in the same manner as they had always done.

The FWO commenced proceedings alleging that Quest had contravened section 357(1) of the FW Act.

FULL FEDERAL COURT INTERPRETATION OF SECTION 357(1)

Although the housekeepers were ultimately found to continue to be Quest employees, on the question of whether Quest had breached section 357(1) of the FW Act, the Full Federal Court of Australia[2] interpreted this section in such a way that it did not cover Quest's representation to the housekeepers about their arrangement with Contracting Solutions.

This is because the representation by Quest was about the contract between the housekeeper employees and Contracting Solutions, and not about the contract between the housekeeper employees and Quest.

The majority said that a "*representation made by an employer to its employee that he or she is providing work as an independent contractor under a contract for services made with another person is not actionable.*"

This interpretation meant that an employer could avoid the sham contracting provision by introducing a third party (a labour hire company) into the contractual arrangement between the employer and the worker who was, in fact, the employee.

The FWO appealed to the High Court.

HIGH COURT INTERPRETATION OF SECTION 357(1)

The High Court allowed the appeal and accepted the FWO's argument that section 357(1) prohibited the misrepresentation that a contract of employment is a contract for services with a third party.

2 *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* [2015] FCAFC 37.

The focus was very much on the fact that the purpose of the sham contracting provisions is to protect a person, who is in truth an employee, from being misled about his or her employment status.

The High Court said that there was nothing in the language of section 357(1) that warranted the section to be construed such that representation prohibited by the section was "*confined to a representation that the contract under which the employee performs or would perform work as an independent contractor is a contract for services with the employer.*"

Importantly, the High Court went on to state:

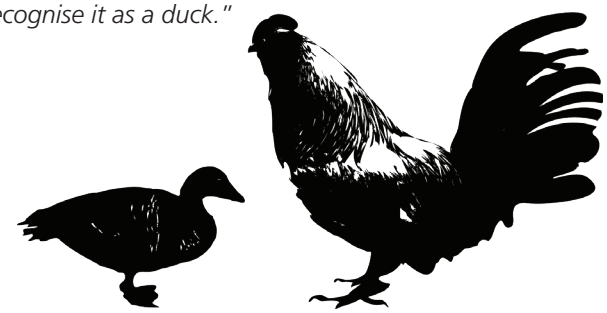
"*To confine the prohibition to a representation that the contract under which the employee performs or would perform work as an independent contractor is a contract for services with the employer would result in s 357(1) doing little to achieve its evident purpose... That purpose is to protect an individual who is in truth an employee from being misled by his or her employer about his or her employment status. It is the status of an employee which attracts the existence of workplace rights.*"

The effect of the High Court's decision is that the prohibition in section 357(1) will extend to employers who interpose a third party into the sham arrangement.

KEY POINTS FOR EMPLOYERS

A third party labour hire arrangement will not permit an employer to avoid the sham contracting provisions where the substance of the relationship between the engaging entity and the worker is, in truth, that of employer and employee.

This decision is significant for any business which uses the Odco system of contracting. It is the nature of the relationship between the parties that is the principal consideration. As the Courts have said in this country on numerous occasions, parties "*cannot create something which has every feature of a rooster, but call it a duck and insist that everybody else recognise it as a duck.*"



While each situation turns on its own facts, employers need to be mindful of potential liability under the FW Act, but also under a range of other employment related legislation, such as tax, superannuation and workers compensation.

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