SHAM CONTRACTING POSES GREAT RISKS FOR EMPLOYERS

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IN BRIEF

- High Court rules that Quest contravened the *Fair Work Act*.
- Incorrectly classifying your employees as 'independent contractors' rather than employees can expose your company to serious risk, adverse consequences and penalties.

WORKERS FOUND TO BE QUEST'S EMPLOYEES, NOT INDEPENDENT CONTRACTORS

Numerous companies are finding themselves subject to penalties imposed for breaches of section 357 of the *Fair Work Act 2009* (Cth) after findings that the 'independent contractors' they have hired are in fact their employees.

It is unlawful for an employer to represent to a person who is in fact its employee that the contract made with that person is a contract for services under which the person performs work as an independent contractor. This is known as 'sham contracting'.

The full bench of the High Court of Australia has handed down its decision in the matter of *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* [2015] HCA 45 and has found that Quest, as the employer, contravened the *Fair Work Act* by representing to two employees that they were engaged under a contract for services under which they performed work as independent contractors, despite the fact that the representation was not made by Quest.

In regard to sham contracting, the court restated a quote from a 1989 Federal Court case that you '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' ((at [21]); Australian House of Representatives, Independent Contractors Bill 2006, Explanatory Memorandum at 9, quoting *Re Porter* [1989] FCA 226; (1989) 34 IR 179 at 184).

WORKERS DESCRIBED AS INDEPENDENT CONTRACTORS UNDER CONTRACTS FOR SERVICES

Quest, which operates a business of providing serviced apartments, had employed two female housekeepers, Ms X and Ms Y.

In October 2009, Quest entered into an agreement with Contracting Solutions Pty Ltd which provided a labour hire system whereby they would arrange for workers to perform work for Quest without there being any contract of employment between the workers and Contracting Solutions or Quest.

As part of the agreement, Contracting Solutions was to procure what it described as the 'conversion' of particular Quest employees. A number of Quest employees were to become independent contractors, under which the employment of those individuals by Quest would terminate. Thereafter, they would perform the exact same service for and under the control and direction of Quest, although they were described as independent contractors under contracts for services.

Contracting Solutions purported to engage Ms X and Ms Y as independent contractors under contracts for services to be provided to Quest under a labour hire agreement.

FAIR WORK OMBUDSMAN INITIALLY FAILS IN BID TO PROVE QUEST HAD BREACHED SECTION 357

At trial in the Federal Court, the Fair Work Ombudsman (FWO) claimed that, in breach of section 357, Quest made representations to Ms X and Ms Y to the effect that after the conversion they would not be its employees but independent contractors performing work at its premises.

Justice McKerracher dismissed the case and found that the FWO failed to establish that Ms X and Ms Y had been constructively dismissed as they had made the choice to sign the contractor agreements.

FULL COURT OF THE FEDERAL COURT FINDS EMPLOYMENT CONTRACT NOT MISCHARACTERISED BY QUEST

The FWO appealed to the Full Court of the Federal Court of Australia, which construed that section 357 of the *Fair Work Act* did not extend to include Quest under circumstances where the representations made to Ms X and Ms Y were made by Contracting Solutions.

In order for Quest to contravene the provision, it needed to mischaracterise the employment contract as one for services made between employee and employer.

HIGH COURT DETERMINES THAT WORKERS REMAINED QUEST EMPLOYEES

The FWO appealed to the High Court of Australia, which disagreed with the confined interpretation of section 357 of the *Fair Work Act* and stated that to confine the representation prohibition would result in section 357 doing little to achieve its purpose; the purpose being:

... to protect an individual who is in truth an employee from being misled by his or her employer about his or her employment status.(at [16])

The High Court determined that Ms X and Ms Y were performing precisely the same work for Quest in the same manner and that in law they never became independent contractors but remained employees of Quest under implied contracts of employment.

The High Court allowed the appeal and declared that Quest contravened section 357 of the *Fair Work Act* in representing to Ms X and Ms Y that they were independent contractors. The matter has now been remitted back to a judge of the Federal Court to determine the pecuniary penalties to be imposed on Quest.

COURTS APPLY MULTIFACTORIAL TEST TO DETERMINE EMPLOYMENT STATUS

The difficulty employers face is that there are no clear indicia to determine that an 'independent contractor' is in fact a 'disguised employee' or a dependent contractor. Recent cases such as *Tattsbett Limited v Sharyn Morrow* [2015] FCAFC 62 (11 May 2015) have confirmed that the courts must use a multifactorial test to determine whether a person is an employee or independent contractor.

The multifactorial test involves an analysis of factors that have been traditionally relevant to the distinction between employees and contractors.

The common hallmarks of an employment relationship have previously been held to be:

- degree of control in regard to how work is performed;
- hours of work and who dictates the hours;
- expectation of work to be provided to the individual;
- who provides the tools, equipment or vehicle;
- whether the individual is required to wear a uniform;
- whether the individual is paid regularly or submits an invoice to the company for their services;
- whether the individual receives an income tax deduction for payment of his or her services;
- whether the individual receives annual leave and superannuation;
- who bears the financial risk;
- whether the individual is engaged under an employment contract or an 'independent contractors' contract;
- whether the employer provides training to the individual;
- whether the individual has his or her own incorporated business;
- who the goodwill of the business rests with; and
- whether the individual has capacity to hire his or her own staff.

While the above is not an exhaustive list, it shows that there is not a simple set of rules that employers can follow as there are a number of factors which may contribute to characterising the individual.

There is no one factor that will be conclusive in determining the relationship of the employee/ independent contractor. Further, it is clear from the decision in *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd* that the courts will look past the engagement of a labour hire entity or other corporate vehicle to assess the proper characterisation of a relationship.

CONTRACTS OF ENGAGEMENT SHOULD BE CAREFULLY CONSIDERED AND REVIEWED

In order to avoid expensive litigation, risk of penalties and liabilities to 'employees', it is strongly recommended that contracts of engagement for services, as well as the performance of the contract and the relationship, are carefully considered and reviewed. Strategies can be implemented to ensure that the intended relationship prevails.

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