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legal update

DUCKING LOOPHOLES – NEW LAWS ON CONTRACTORS AND EMPLOYEES

New employment laws aimed at closing loopholes will need to be considered carefully by insolvency practitioners.

"If it's not a duck that thinks it's a rooster, it's a pig that thinks it's a dog.

Babe, 1995

As part of broader reforms, two aspects of the new laws are of particular relevance to practitioners. The first is specifically stated to undo recent judicial pronouncements on the distinction between employees and contractors. This will leave greater uncertainty for insolvency practitioners seeking to determine whether a creditor has priority as an employee or is merely an ordinary unsecured creditor. The second will benefit creditors and liquidators winding down a trading business, and actually close a loophole in the small business redundancy exemption.

IS IT A ROOSTER OR IS IT A DUCK?

For decades courts have been required to grapple with the ongoing struggle between business operators and business workers to define their legal arrangements in the way most beneficial to either party.

Generally, workers want employee entitlements, while operators want workers to be independent contractors, and do their best to define them as such in contractual arrangements.

In essence, the court is being asked to determine the answer to the question: "Is it a rooster, or is it a duck." Or at least that was what Justice Gray held in a case involving the Transport Workers' Union, whose rules required a candidate for office to be "employed in the industry". In finding they were employees, the Court held: "the 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".[1]

THE MULTIFACTORIAL APPROACH

Therefore, over many years the courts have developed what has been described as a 'multifactorial' approach to determining whether someone is an employee or a contractor. While the lists of factors and the weight to be given to each one has varied over time and by reference to different circumstances, the list includes such matters as:

- degree of control
- mode of remuneration
- provision and maintenance of equipment or resources
- obligation to work
- hours of work and provision for holidays
- deduction of income tax, and
- delegation of work.[2]

All such lists have been qualified, "any attempt to list the relevant matters, however incompletely, may mislead because they can be no more than a guide to the existence of the relationship of master and servant."[3]

THE HIGH COURT SPOTS A ROOSTER

However, in two cases heard in 2022 the High Court dramatically reframed the multifactorial approach in a way that reinforced the primacy of the contract between the parties. Essentially, the High Court held that in the absence of a sham, fraud or unconscionable conduct, such that the parties were not able to enter their bargain equitably, the Court should have primary regard to the terms of the contract.

1 *Re Porter* [1989] FCA 342; 23 FCR 251, at [13]. **2** See for instance *Stevens v Brodribb Sawmilling Co Pty Ltd* [1986] HCA 1 per Mason J (with whom Brennan J agreed) at [9]; cf Wilson & Dawson JJ at [11]. **3** *Stevens* per Wilson & Dawson JJ at [12].

The High Court did not dispense with the multifactorial approach entirely, but held that the whole point of looking at each of these factors was to consider **what the contract** said about them, in order to determine whether someone was an employee or a contractor.

Personnel Contracting

In *Personnel Contracting*[4] the High Court considered a 22-year-old British backpacker (Mr McCourt) who travelled to Australia on a working holiday visa, looking for construction work. Mr McCourt entered into an Administrative Services Agreement (ASA) as a "self-employed contractor" with Construct, a labour hire company based in Perth. He could work when he wanted, and had his own equipment – albeit this consisted of a hard hat, steel-capped boots and high visibility clothing purchased for less than $100. McCourt worked on two sites performing basic labouring work under the supervision and direction of Hanssen Pty Ltd ("Hanssen") employees. Construct had a separate "Labour Hire Agreement" with Hanssen pursuant to which Construct provided around 75% of workers for Hanssen projects. After not being offered any further work, Mr McCourt and the CFMEU commenced proceedings against Construct seeking compensation and penalties in accordance with McCourt's entitlements as an employee.

The primary judge (O'Callaghan J) applied the multifactorial approach but held that the various factors were "evenly balanced". Therefore, he decided the case on the basis that the ASA described Mr McCourt as "the Contractor" and there was no reason to suggest the parties did not intend to

4 *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1.

"The 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.

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mean what they said. This decision was upheld on appeal by the Full Court of the Federal Court of Australia, although the Full Court found the idea (that a 22-year-old backpacker was an independent contractor) to be "somewhat less than intuitively sound". Nevertheless, the Full Court was bound by a different case 18 years earlier, ironically involving "essentially the same dispute between the same parties".[5]

However, a majority of the High Court allowed the appeal and held that Mr McCourt was an employee, despite the 'label' in the ASA. In doing so, the majority held that the approach of the Full Court to the application of the multifactorial approach was "problematic", agreeing with Justice Lee in the Full Court who described the test as "distinctly amorphous" and "necessarily impressionistic".[6]

The majority held that for many years the cases had misapplied the test, which had never been intended as an equal checklist of "ticks and crosses" (Kiefel CJ, Keane and Edelman JJ at [34]). Instead, the Court said that what was required was to give primacy to the **effect** of the contract, if not the labels used, especially where the arrangements were reduced to writing (at [59]):

> Where the parties have comprehensively committed the terms of their relationship to a written contract the validity of which is not in dispute, the characterisation of their relationship as one of employment or otherwise proceeds by reference to the rights and obligations of the parties under that contract.

However, this:

> ... is distinctly not to say that the "label" which the parties may have chosen to describe their relationship is determinative of, or even relevant to, that characterisation (at [63]).

The majority held that Mr McCourt "served in the business" of Construct, and despite the language of the ASA, Construct had to accept Mr McCourt was not carrying on his own business (at [68]). McCourt was subject to the control of Construct, who determined for whom he was to work, and agreed (with Construct) to abide the directions of its customer. The right to control the provision of Mr McCourt's labour was an essential asset of Construct's business. Mr McCourt's work for Hanssen was a direct result of the deployment of this asset. Kiefel CJ, Keane J and Edelman J held that in these circumstances it is "impossible to conclude other than that. [Mr McCourt was an] employee not contractor".

Jamsek

In a case heard one day later, and with judgment delivered on the same day as *Personnel Contracting*, the High Court reached the opposite conclusion in *Jamsek*.[7]

Jamsek involved two truck drivers, Jamsek and Whitby. Both worked in the same business for 40 years between 1977 and 2017 driving trucks and making deliveries. Both were initially engaged as employees of the company for eight to nine years, before becoming "contractors" at the 'request' of their employer, purchasing their own trucks, and entering into new agreements as independent contractors in partnership with their respective spouses. The drivers' roles, work and functions remained largely unchanged and, 29 years later in 2017, their contracts were terminated. The drivers commenced proceedings seeking entitlements as employees of the company.

So, were they contractors, or employees? Roosters, or ducks?

At first instance the primary judge (Thawley J) held the drivers were "independent contractors". The Full Court of the Federal Court of Australia (Perram, Wigney and Anderson JJ) instead held the drivers were employees. The Full Court considered that the drivers' spouses were "partners in name only" and the drivers had been given "an effective ultimatum", before expressing:

> a preference for the **substance** of the relationship ... over certain aspects of the contractual obligations governing the relationship, and the legal structures through which the [drivers] contracted.[8]

However, the High Court held that the Full Court's "expansive approach taken to determining the 'substance and reality' of the relationship" (per Kiefel CJ, Keane & Edelman JJ at [51]) was incorrect. In rejecting the drivers' submissions, the High Court held they amounted to a "disguised submission of sham" (at [63]) made "under the obscurantist guise of a search for the 'reality' of the situation" (at [62]).

Here the Court held that the "reality of the situation" was that it was the partnerships, not the drivers, which owned and operated the trucks, contracted with, invoiced and earned money from the company, incurred expenses and obtained structural tax advantages. It was they, in reality, who were carrying on the business and

5 *Personnel Contracting Pty Ltd v Construction, Forestry, Mining and Energy Union of Workers* (2004) 141 IR 31. **6** *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* (2020) 279 FCR 631 at 654-655 [74]-[76]. **7** *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2; 275 CLR 254. **8** *Jamsek v ZG Operations Australia Pty Ltd* (2020) 279 FCR 114 at 165 [243] (emphasis added).

"compendiously" providing the truck driving skills of the drivers and the use of the trucks, as independent contractors.

High Court loophole closed

The High Court had determined that decades of case law had wrongly focused on the multifactorial approach: i.e. on how a worker/business relationship operated in practice, rather than the legal terms of the contract. While a significant change, it may have been hoped that the result would be more predictable instead of an "amorphous" and "impressionistic" uncertainty.

However, in the *Fair Work Legislation (Closing Loopholes Act) (No 2)* 2024 (Cth), the Federal Government introduced s 15AA of the *Fair Work Act 2009* to specifically overcome the effect of the two High Court decisions and return to the primacy of the multifactorial approach. If the High Court was in doubt that it was the cause of this amendment, s 15AA contains a note that: "This section was enacted as a response to the decisions of the High Court of Australia in [Personnel] and [Jamsek]."

Instead, the section now legislates the multifactorial approach, by prescribing that the relationship of employee/employer (s 15AA(1)):

> is to be determined by ascertaining the real substance, practical reality and true nature of the relationship between the individual and the person.

Subsection (2)(a) says that this **must** involve consideration of "the totality of the relationship" and 2(b) says that this means having regard "not only to the terms of the contract … but also to other factors … including, but not limited to, how the contract is performed in practice."

Silent (or violent) revolution?

So, is this just a return to the 'true' position before *Personnel* and *Jamsek*? In one sense this cannot be correct, since *Personnel* found that the 'true' position as determined by the cases had always been to give primary effect to the terms of the contract – see the careful explanation at [40]-[62]. "In case after case, this Court can be seen to be applying basic, established principles of contract law rather than effecting a silent revolution" (at [52]).

It would seem there is now a rather loud revolution and a statutory, rather than judicial, basis to determine the relationship between employer/independent contractor. It remains to be seen how on earth the courts will apply the previous decisions which the High Court had relied upon to reach its conclusion! It is not unreasonable to expect that uncertain times are ahead, both for roosters and for ducks.

These amendments are scheduled to commence on 26 August 2024.

SMALL BUSINESS REDUNDANCY EXEMPTION

By contrast, one area where the 'Closing Loopholes' legislation does provide real certainty is in respect of the small business redundancy exemption.

Practitioners may be familiar with s 121 of the *Fair Work Act 2009* (Cth) which was introduced as an aid to small business by providing an exemption to the requirement to pay redundancy entitlements where the business had less than 15 employees.

However, this produced a loophole in external administrations where a previously large business became a small business due to staff layoffs in the course of a trade-on. For instance, in *Bullivant and Secretary, Attorney-General's Department* [2020] AATA 2047 Ms Bullivant stayed on to assist the administrators, but in the meantime the number of employees dropped from 60 to 13 before her employment was terminated. Ms Bullivant had no statutory entitlement to redundancy pay, but was fortunate in that the tribunal found the administrators had bound themselves to pay her redundancy pay as a condition of her agreement to stay on.

This loophole has now been closed by *Fair Work Legislation Amendment (Closing Loopholes) Act 2023* (Cth). This introduced s 121(4) of the *Fair Work Act 2009* to provide that redundancy is still payable if an employer is bankrupt/being wound up (other than a members' voluntary liquidation) and only became a small business employer because of terminations which occurred because of insolvency or during the six months before the appointment of an insolvency practitioner.

This is a positive amendment which will allow certainty for insolvency practitioners and employees during trade-ons.

TAKEAWAYS – GET YOUR DUCKS IN A ROW

The old employee/contractor multifactorial assessment, which the High Court found to have been misapplied, is now cemented in a statutory form and insolvency practitioners will need to look at the 'reality' of the relationship where the terms of any contract are only one factor to consider.

On the other hand, insolvency practitioners can have some certainty that as they wind down a business, employees otherwise entitled to redundancy will retain those entitlements even if the business becomes a small business employer.