MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

# COVERSHEET

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**Information redacted** **YES**

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- Maintenance of the law
- Confidential advice to Government

In Confidence

Office of the Minister for Workplace Relations and Safety

Chair, Cabinet Economic Development Committee

# Strengthening protections for vulnerable contractors – Approval to consult

## Proposal

1. This paper seeks agreement to consult the public on options to strengthen legal protections for vulnerable contractors.

## Executive Summary

2. In New Zealand, there are two types of paid workers: employees and contractors. Employees have a range of minimum rights in law, including the right to be paid at least the minimum wage, the right to paid holidays, and the right to protection against unfair dismissal. Contractors have fewer rights, but generally enjoy high levels of choice, flexibility and control in their work lives. They operate their own businesses, can work for multiple organisations, and usually set their own pay and hours of work.

3. However, the lack of legal protections leaves some contractors vulnerable to poor outcomes. There are growing concerns about two types of workers:

   **3.1.** Workers that are in substance employees, but are misclassified as contractors by firms in order to reduce their entitlements.

   **3.2.** 'Dependent contractors' who occupy a 'grey zone' between employee and contractor status, missing out on both the choice and flexibility associated with self-employment, and the legal protections afforded to employees.

4. There is limited data in this area, which means it is not possible to precisely quantify the scale of the issues affecting contractors in New Zealand. However, it is clear that both 'types' of worker described above are in a vulnerable position, lacking both the protections offered by law, as well as the ability to negotiate a better deal.

5. Numerous reports from the media, workers and unions detailing poor working conditions among contractors convince me that government needs to consider whether current regulatory settings are fit for purpose. In 2015, Hon David Parker's Member's Bill, the Minimum Wage (Contractor Remuneration) Amendment Bill, provided a focal point for those concerns. The Bill was supported by the Labour, New Zealand First, and Green Parties. This support reflected our shared concern about the poor outcomes being experienced by certain groups of contractors.

6. The changing nature of work, including the expansion of the 'gig' economy, is likely to increase the prevalence of low-paid contracting work in New Zealand. While the data does not yet show a significant recent increase in rates of self-employment in

New Zealand, such a shift has already been experienced in several international jurisdictions (for example, the UK and California), leading to a large number of workers being placed beyond the reach of labour regulation in these countries. This explains why 'future-proofing' our system – by exploring options such as those set out in this paper – is one of the key priorities of the Future of Work Tripartite Forum.

7. I now seek Cabinet approval to consult the public on four groups of possible options for change. Engaging the public at this stage will assist us both to understand the nature of the issues in this area, and to assess the likely costs and benefits of the options identified.

8. The development of the options was guided by three core objectives:

   **8.1.** Make our system of statutory labour standards more protective and accessible for workers who are misclassified as contractors.

   **8.2.** Reduce the imbalance of bargaining power between firms and contractors who are vulnerable to poor outcomes.

   **8.3.** Ensure that the system settings encourage inclusive economic growth and competition.

9. A balance will need to be struck between achievement of these objectives and protecting contractors' freedom to take on risk. In particular, it will be important to ensure any changes do not restrict entrepreneurship, innovation and firm growth.

10. If Cabinet agrees to consult, the attached consultation document will be uploaded to an online platform for a period of six weeks, from 11 November until 20 December 2019. I will report back to Cabinet in April or May 2020 to seek agreement on final policy proposals.



## Background

### *The 'employment relationship' underpins most labour regulation in New Zealand*

11. The distinction between employees and contractors reflects historical assumptions about two different types of legal relationship:

   **11.1.** The concept of the 'employment relationship' (and the 'contract of service') evolved from the idea of master/servant relationships. Employment protections are largely based on the assumption of a permanent/ongoing relationship between the parties, in which employers have a high degree of control over their employees. Parties to an employment relationship owe each other a duty of good faith, which requires them to be active and constructive in establishing and maintaining a productive relationship.

   **11.2.** The concept of a 'contractor/principal relationship' comes from ordinary contract law, and a 'contract for services' is assumed to be an arm's length contract between two independent entities. Contractors are assumed to be operating in business on their own account, and to accept the risks and benefits of doing so. In accepting these risks, contractors are able to profit from the benefits of these risks in a way employees cannot.

12. The different origins of these concepts explains why various rights and protections – including the minimum wage, paid leave, and the right to bargain collectively – apply only to employees, and do not apply to contractors. The law recognises an inherent imbalance of bargaining power between the parties to an employment relationship. There is no such assumption in commercial law, which generally respects parties' freedom of contract.

13. In many instances, these settings can be mutually beneficial for both firms and contractors. Firms with uncertain demand benefit from offering flexible, short-term contracts. Workers may choose to accept work as a contractor to suit their individual lifestyle and preferences. Some enjoy high levels of bargaining power, and can negotiate enhanced remuneration and flexibility that makes minimum employment standards less relevant to their working lives.

14. However, it is evident that for firms aiming to minimise labour costs and maximise workforce flexibility, there can be a range of incentives to classify workers as contractors rather than employees. There is obvious potential for contractor status to be imposed on workers with low bargaining power, resulting in downward pressure on wages and working conditions.

***Existing law provides an avenue for some contractors to assert employment rights...***

15. The Employment Relations Act 2000 (the ER Act) allows most workers to challenge their employment status through the courts, based on the 'real nature of the relationship' between the parties (section 6). This means that a person's employment status will rest on questions of substance (eg how does the working relationship function in practice?) rather than questions of form (eg what does it state in the written contract?).[1] Status determinations are based on the application of a series of tests that have developed in the common law, including:

    **15.1.** 'the intention test' (the intention of the parties)

    **15.2.** 'the control test' (the degree of control the firm has over the worker)

    **15.3.** 'the independence test' (the level of independence the worker has when performing the work)

    **15.4.** 'the integration test' (how integrated the worker is in the business)

    **15.5.** 'the fundamental or economic reality test' (whether the worker is operating as a business in their own right).

16. Applying these tests to a particular working relationship is a fact-based exercise for the courts. There is considerable scope for subjectivity in judicial decision-making, and several leading cases on employment status have been reversed on appeal.

1 Section 6 of the Employment Relations Act 2000 is limited in relation to: film production workers (as a result of the Employment Relations (Film Production Work) Amendment Act 2010) real estate agents (covered by the Real Estate Agents Act 2008) and sharemilkers (covered by the Sharemilking Agreements Act 1937). Homeworkers (persons contracted in the course of another person's trade or business to do work in a dwellinghouse) are deemed to be employees.

17. New Zealand's general settings for determining employment status are close to international recommended practice. The International Labour Organisation recommends that states adopt policies to:

> 'combat disguised employment relationships in the context of […] other forms of contractual arrangements that hide the true legal status, noting that a disguised employment relationship occurs when the employer treats an individual as other than an employee in a manner that hides his or her true legal status […], and that situations can arise where contractual arrangements have the effect of depriving workers of the protection they are due'.[2]

***… but gaps remain that require attention***

18. While our legal settings do provide a pathway for workers to assert employment rights, these can be difficult to access in practice (see paragraph 61). Moreover, these settings only protect misclassified workers. For vulnerable contractors who would not satisfy the common law tests, there are no obvious mechanisms available to access better pay and working conditions.

19. Concerns have been raised about contractors' working conditions over many years. In 2015, Hon David Parker's Member's Bill, the Minimum Wage (Contractor Remuneration) Amendment Bill, provided a focal point for those concerns. The Transport and Industrial Relations Committee heard evidence of firms hiring vulnerable workers as contractors (despite the working relationships being more akin to employment relationships), and of low remuneration among contractors in a range of occupations.

20. The Minimum Wage (Contractor Remuneration) Amendment Bill was supported by the Labour, New Zealand First, and Green Parties. This support reflected our shared concern about the poor outcomes being experienced by certain groups of contractors, such as courier and truck drivers. At the same time, we recognised that the mechanism proposed by that bill (extending minimum wage protection to certain contractors providing a specific list of services) may have resulted in unintended consequences, and would not have addressed all the issues that submitters were concerned about.

21. This Government has taken steps to improve labour market outcomes for one industry, by agreeing to implement a bespoke collective bargaining system for contractors doing screen production work [DEV-19-MIN-0140]. On the recommendation of the Minister for Small Business and the Minister of Commerce and Consumer Affairs, Cabinet has also agreed to introduce protections for businesses against unfair contract terms [DEV-19-MIN-0189]. These changes have the potential to enhance some contractors' ability to challenge one-sided contracts.

22. In February this year, I directed officials to develop options to strengthen the legal protections for vulnerable contractors. I asked that this work be connected with:

**22.1.** policy discussions already underway in the Future of Work Tripartite Forum. Protecting vulnerable workers is a key strategic priority for the Forum.

2 International Labour Organisation, Recommendation on the Employment Relationship (R198, 2006)

**22.2.** the consultation on Fair Pay Agreements, which would create a new mechanism for collective bargaining to set binding minimum wages and terms across an occupation or sector [DEV-18-MIN-0100, DEV-19-MIN-0266]

**22.3.** the work to address temporary migrant worker exploitation [CAB-18-MIN-0434].

23. This paper summarises the initial conclusions of that policy work, and sets out the options that I propose to consult the public on. Engaging the public early in the process provides a valuable opportunity to develop a comprehensive response to the issues faced by contractors with low bargaining power in New Zealand.

**Employees are being misclassified as contractors, and some workers are caught in a 'grey zone' between the employee and contractor categories**

24. There are over 140,000 self-employed contractors in New Zealand,[3] which is more than 5 per cent of the total employed population.[4]

25. Many of these people will have high bargaining power, and will choose self-employment because of the potential benefits. Compared with employees, independent contractors have fewer rights, but can enjoy high levels of choice, flexibility and control in their work lives. 'Typical' contractors operate their own business, can work for multiple organisations and usually set their own pay and hours of work.

26. However, for some workers, the experience of being a contractor diverges from that of the 'typical' self-employed person described above. Research by the NZ Council of Trade Unions in 2017 highlighted that a number of self-employed workers report very low incomes (based on the New Zealand Income Survey).[5] While the significance of this finding is unclear, it does lend some weight to stakeholders' concerns that our current system for assigning employment rights to employees leaves some contractors vulnerable to exploitation. There are growing concerns about two types of workers, as follows:

**26.1.** Workers that are in substance employees, but are misclassified as 'independent contractors' by firms to reduce their entitlements. These workers are often subject to a high degree of control (they perform tasks under close supervision and are unable to substitute their labour) but lack basic employment rights. They might be paid less than the minimum wage, have no paid holidays and can be dismissed without notice or reason.

3 Contractors comprise 47 per cent of the self-employed without employees population. Stats NZ notes that the challenge in identifying how many people work as contractors is that the distinctions between employees, self-employed contractors, and other types of self-employed people are not always clear-cut. To make these distinctions, Stats NZ relied on people's own view of their employment status instead of applying any legal criteria, with the survey asking self-employed people with no employees whether they worked as contractors in their main job.

4 Survey of Working Life supplement to Stats NZ's Household Labour Force Survey (HLFS). This survey was run in the December 2018 quarter.

5 Dr Bill Rosenberg, 'Shrinking portions to low and middle-income earners: Inequality in wages and self-employment, 1998-2015', August 2017. This finding relates to the 'self-employed' category, which includes but is not limited to the 'contractor' group described at paragraph 23. I also note that this finding may partly be attributed to the ability of self-employed people to under-report their incomes.

**26.2.** Workers that occupy the 'grey zone' between employee and contractor status. These workers operate their own businesses and may use their own equipment, but depend on one firm for the majority of their income, and have little control over their daily work. These workers do not enjoy the choice and flexibility commonly associated with self-employment, nor do they have the same legal protections as employees.

27. There is significant overlap between workers who are simply misclassified (paragraph 25.1) and those whose employment status is genuinely ambiguous (paragraph 25.2). For example, some commentators see platform workers (such as Uber drivers) as an example of the former, while others see them as an example of the latter.[6] Deciding the 'real nature of the relationship' between parties – as courts are directed to do when determining a worker's employment status – can be complex and ambiguous. A leading legal text describes a 'wide scope for the exercise of a 'value judgment' by the Court in answering the extremely vague question which the test poses'.[7] This complicates any attempt to break down the contractor population into clearly bounded groups.

28. While acknowledging this overlap, there is value in maintaining a working distinction between the two types of worker described at paragraph 25, as the two groups serve to highlight different problems and policy responses.

***Issue 1: Misclassified workers are missing out on their rightful employment entitlements***

29. Firms have a range of incentives to misclassify workers as contractors, including: avoiding employment and tax obligations; shifting business risk and costs onto workers; and hiding one-sided terms and exploitation of workers that would have breached employment law if the workers had been correctly classified. These practices can enable non-compliant firms to gain a competitive advantage over compliant firms.

30 The common law tests described at paragraph 14 are widely known, and guidance on their application is available on the respective websites maintained by the Ministry of Business, Innovation and Employment (MBIE) and Inland Revenue (IR). Nonetheless, the issue of vulnerable workers being misclassified as contractors persists. As this is a 'hidden' problem, it is not possible to state definitively how widespread the issue is, but there are clearly pockets of bad practice. For example:

**30.1.** between 1 July 2018 and 30 June 2019, MBIE's Employment Services contact centre received 133 calls from self-employed contractors relating to employment status, 234 calls relating to wages and pay, and 89 calls relating to ending employment, including unjustified dismissal.

**30.2.** between March 2017 and April 2019, there were 40 Employment Relations Authority (ERA) determinations and one Employment Court (the court) decision regarding employment status. Forty one per cent of these cases

6 The employment status of Uber drivers has not been tested in New Zealand, but there have been high profile cases in a number of jurisdictions (eg California, the UK and Australia), with divergent outcomes.
7 Mazengarb's Employment Law, at para ERA 6.9.1.

found that the 'real nature of the relationship' was one of employment (17 cases).

31. Misclassification has occurred in many sectors. Cases have been recorded in the education, automotive, health, construction, retail, printing, transport, real estate, telemarketing and insurance industries.[8]

32. This data is likely to understate the problem, as reported instances cannot reflect the true prevalence of an under-reported issue.

33. For workers who are misclassified, the negative consequences can be wide-ranging. For example, there have been numerous reports of workers signing 'independent contractor' agreements without understanding the consequences of doing so, and discovering later that they should have been filing their own tax and ACC payments. Such workers might be aware that their contract does not entitle them to paid leave or employer KiwiSaver contributions, but they may underestimate the value of these entitlements (both in terms of wellbeing and monetary value)

34. Misclassification also exacerbates the challenges workers face when a job ends unexpectedly. Uncertainty about a worker's employment status will complicate any attempt to claim back unpaid wages, and workers can only seek redress for unjustified dismissal if they first demonstrate that they were, in fact, an employee.

35. The misclassification of workers can undermine fair competition between businesses. Firms that shift risk onto workers (by deeming them to be contractors) may have an unfair advantage over firms that legitimately employ their workforce.

36. Alongside the problems misclassification generates for firms and workers, this is also a significant issue of public interest. By deeming workers to be contractors, firms transfer the responsibility of paying tax and ACC contributions onto the workers. Some workers may be less well equipped to bear the associated compliance costs, which increases the likelihood of non-payment. This can damage public finances, as Pay As You Earn (PAYE) is an important source of tax revenue and made up 33 per cent of New Zealand's total tax revenue in 2018/19.[9]

***Issue 2: Workers in the 'grey zone' may not be adequately protected by employment law or commercial law***

37. The second 'type' of vulnerable contractors presents challenges of a different nature. These are workers who share some characteristics with typical self-employed people (eg run their own business and use their own equipment) and some with employees. They may, for example:

    **37.1.** be highly dependent on one firm or client for the majority of their income

    **37.2.** exercise limited control over their day-to-day work and working arrangements.

38. It is this group of people who are most commonly described as 'dependent contractors'. Applying the common law tests described at paragraph 14 to people in

8 Administrative data collected by Employment Services and MBIE Service Centre.

9 The Treasury, 2019 Budget Economic and Fiscal Update '2018/19 Tax Revenue Year-to-date to May'

these working arrangements would produce an ambiguous result that does not definitively place them in either category. Some firms may take advantage of this ambiguity and structure their affairs to hire contractors rather than employees, whether or not the nature of the work is best suited to a contractor relationship. This can allow firms to pass more risk onto workers.

39. For the first time, Statistics New Zealand's 2018 *Survey of Working Life* (SoWL) was designed to provide an indication of the number of dependent contractors in New Zealand. In the December 2018 quarter, half of all contractors (71,200 contractors) said they relied on one client or business for most of their work. However, 73 per cent said they were usually able to work on contracts with more than one client or business at a time. Some contractors said they had little or no control over how their daily work was organised (8,900 contractors), how their tasks were done (6,200 contractors) and/or decisions that affected their tasks (12,000 contractors).[10]

40. Overall, this suggests that the issue of contractors being both dependent on a single 'payer' and exercising limited control over their working arrangements is confined to a relatively small proportion of the contractor population (though this is still a significant number of people). Moreover, it is important to note that the data may not tell the full story. It is based on people's view of their employment status in their main job, rather than the application of any legal criteria. This means it may not capture every worker who is being treated as a contractor in New Zealand. The data also does not include self-employed contractors who employ people themselves.

41. Contractors must rely on negotiation to secure decent income and working conditions. However, compared to truly independent businesspeople, dependent contractors are less likely to have sufficient bargaining power to negotiate favourable terms. This is especially true in cases where dependent contractors are offered standard-form contracts on a 'take it or leave it' basis. In several industries, there are reports of such contracts effectively denying workers the benefits of either employment (minimum standards) or self-employment (choice and flexibility), for example:

    **41.1. Trucking**: news and academic reports claim that some companies are cutting costs to an unsustainable level, leaving contracted truck drivers facing high levels of debt and financial strain. Low wages and the financial pressures associated with ensuring the survival of their company are seen to force many drivers to work very long hours (70-90 hours a week) with no breaks, which puts them particularly at risk of work-related injury and disease.

    **41.2. Telecommunications:** contractors engaged to deliver various components of the Chorus-led Ultra-Fast Broadband (UFB) rollout have expressed concerns about the one-sided terms that they were subject to, such as unilateral variations to payment rates or contract terms. Many of these contractors are employers themselves, and claim that they had to engage in cost-cutting practices – such as breaches of minimum standards – to meet the terms of their contracts.

10 Survey of Working Life supplement to Stats NZ's Household Labour Force Survey (HLFS). This survey was run in the December 2018 quarter.

**41.3. Courier drivers:** News reports have highlighted that some drivers: have to pay for their own vehicles, uniforms and scanners; receive pay that often falls below the minimum wage; are required to follow the full policy of the company; and are not allowed to subcontract to any other company or person. First Union is currently taking legal action on behalf of a group of courier drivers to claim that they are in fact employees, not contractors. This again demonstrates that the issues of worker misclassification (non-compliance) and potential gaps in our regulatory framework (coverage and ambiguity) are tightly interrelated.

**41.4. Cleaners:** Recent consultation with government agencies that manage cleaning contracts, and industry representatives, as part of recent changes to the New Zealand Government Procurement Rules [CAB-18-MIN-0516.01], highlighted reports of self-employed cleaning sub-contractors receiving take-home pay below the minimum wage.

**41.5. Uber drivers:** While drivers can choose when to offer their services, many other aspects of their working lives are subject to close control. Drivers in Auckland have protested unilateral decisions that have reduced their take-home pay, to the point where some trips are uneconomic.

42. The above examples illustrate the 'grey zone' of dependent contracting particularly well. However, these examples are not intended to suggest that the problems experienced by contractors with low bargaining power are confined to just a few sectors.

43. Similar stories are likely to be found wherever business models rely on contracting to shift risk onto workers. Given the changing nature of work, including the expansion of the 'gig' economy, it is possible that contract-based working arrangements, with limited ability on the part of the worker to negotiate pay or other terms, will become the norm for a growing number of workers in New Zealand.

**Responding to the challenges faced by vulnerable contractors**

44. The issues affecting vulnerable contractors are complex, and there are no easy fixes. On one hand, ensuring that more vulnerable workers are classified as employees would seem to offer a range of benefits – both to the workers themselves and to the economy as a whole. On the other hand, it is clear that many contractors – including vulnerable contractors – identify more as commercial entities operating in business environments.

45. In the December 2018 quarter Survey of Working Life, most contractors (9 out of 10) said they were satisfied or very satisfied with their job, and the same proportion said they would prefer to continue being self-employed than to work in a paid job for someone else. Any attempt to provide greater protections for vulnerable contractors is likely to have some negative impacts on individuals' freedom of choice.

46. However, recognising this complexity is no excuse for accepting the status quo. Accordingly, I directed my officials to develop a range of options to improve the working lives of vulnerable contractors, focusing on the two 'types' of contractor I referred to above (misclassified employees, and workers in the 'grey zone' between

employee and contractor categories). The development of these options was guided by three core objectives:

**46.1.** Make our system of statutory labour standards more protective and accessible for workers who are misclassified as contractors.

**46.2.** Reduce the imbalance of bargaining power between firms and contractors who are vulnerable to poor outcomes.

**46.3.** Ensure that the system settings encourage inclusive economic growth and competition.

47. It will be important to seek to achieve these objectives as efficiently as possible, and with minimal adverse consequences. Accordingly, before recommending any changes to Cabinet, the options will be assessed against criteria consistent with Treasury's *Best Practice Regulation Principles*. This will ensure that appropriate weighting is given to ensuring that any changes minimise costs for all parties, and are compatible with our wider economic objectives.

48. This project aims to enhance the wellbeing of working people – regardless of the legal categories being used to describe and organise their work – and this is clearly consistent with our overall wellbeing agenda. However, I also recognise that innovative business models, entrepreneurship, and healthy commercial competition are important foundations for societal wellbeing. We need to preserve a balance between protecting contractors' freedom to take on risk, with suitable protection for workers who are vulnerable to exploitation. In developing this work further, I will seek to mitigate the risk of dampening innovation and firm growth.

49. I now propose to seek public feedback on four groups of options for change. The options are informed by recommendations made by the Organisation for Economic Co-operation and Development (OECD), and a review of international practice. However, different jurisdictions are taking different approaches, and it is too early to tell which approach will prove most effective.

50. The options are at an early stage of development, and most options are not mutually exclusive. Accordingly, the discussion document aims to elicit wide engagement on a range of possible ideas for change, which could be combined in any number of ways, rather than seeking feedback on well-developed proposals. This approach will build our understanding of the problems affecting contractors, and the benefits and risks of different choices.

51. The four sets of options are:

**51.1.** Deterring the misclassification of employees as contractors (options 1-3). I propose to test three options that enhance the deterrence effect of proactive regulatory action by the Labour Inspectorate in targeting deliberate non-compliance by firms.

**51.2.** Make it easier for workers to access a determination of their employment status (options 4-7). We already have a pathway for workers to challenge their

status, but the judicial system is seen as expensive and onerous. I propose testing four options to make status determinations more accessible.

**51.3.** Change who is an employee under New Zealand law (options 8-9). I propose to test two options that would change the way our legal system distinguishes between employees and contractors. These options could have benefits both for obviously misclassified workers, and workers in the current 'grey zone'.

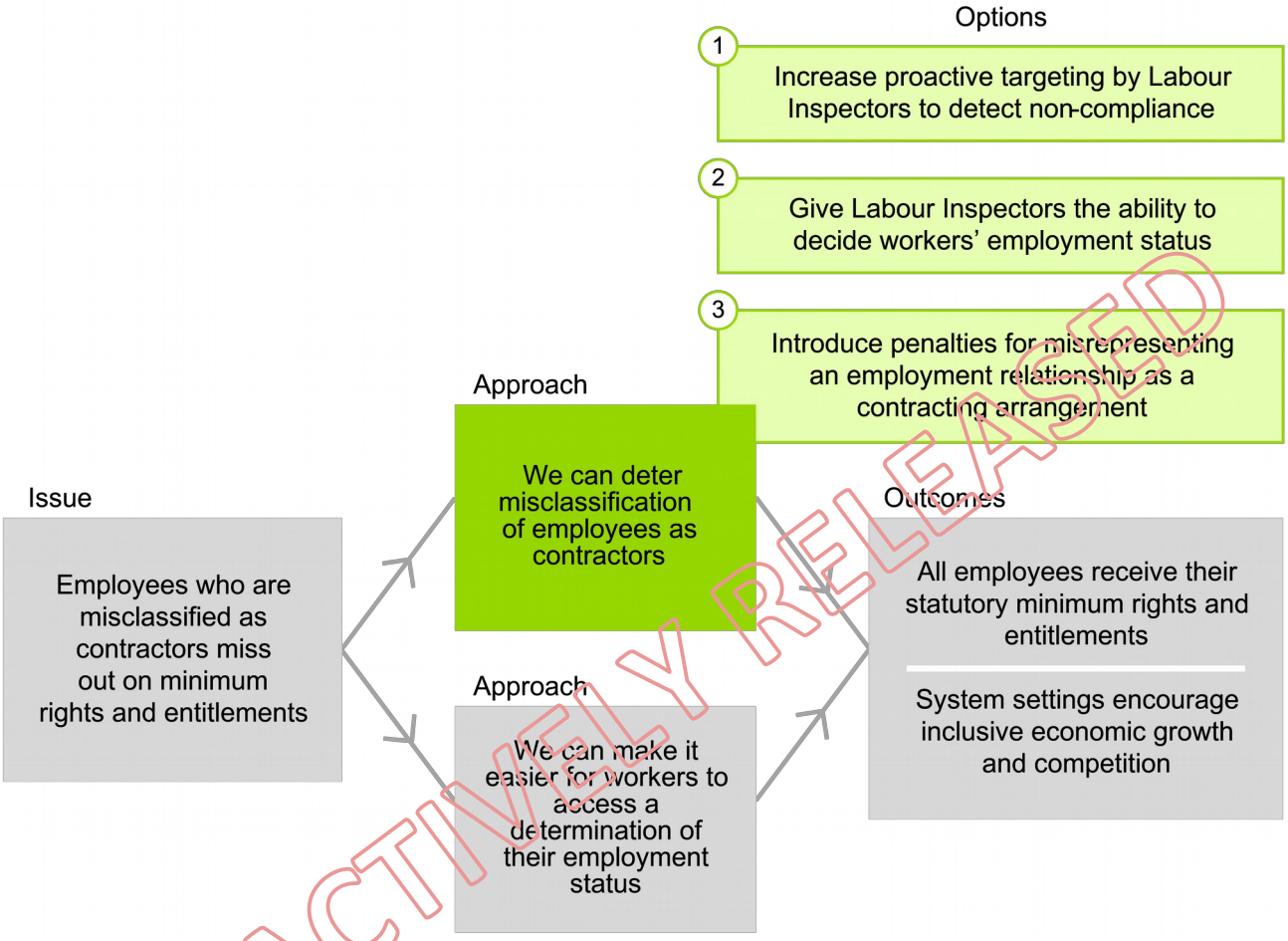
**51.4.** Enhancing protections for contractors without making them employees (options 10-11). As the recent Film Industry Working Group demonstrated, some workers in the 'grey zone' would prefer to remain as contractors – but may support changes to bolster the rights of contracting parties outside the current employment law framework. I plan to test two options in this category.

52. The options would all require some degree of legislative change. The Future of Work Tripartite Forum has discussed a need to future-proof our regulatory settings by moving towards regulating all 'work' rather than 'employment'. This is attractive as a concept, but would be a radical change for our regulatory systems. Some of the options above would move our system further towards this future state; others rely on improving the status quo by making the existing 'employment'-based protections more inclusive.

53. Generally, the options grouped as 'Changing who is an employee under New Zealand law' and 'Enhancing protections for contractors without making them employees' would involve more substantial disruption to existing legal frameworks than the options in the first two themes.

54. Non-regulatory options were considered (such as improving guidance material), but alone these options would not address the biggest problems identified. Better guidance would not address situations where workers are intentionally misclassified to avoid certain costs and obligations. Nor can guidance resolve all situations where there is genuine legal confusion about whether a worker is an employee or a contractor.

***Options to deter the misclassification of employees as contractors***






55. The Labour Inspectorate is the regulator responsible for enforcing employment standards. The Inspectorate has, in recent years, adopted an increasingly proactive enforcement approach in a number of sectors. However, the Inspectorate's ability to make an impact on the issue of misclassification has been limited both by resource availability Maintenance of the law

56. [redacted]

57. I am considering the merits of increasing regulatory action in this area. Accordingly, **<u>option 1</u> is to increase proactive targeting by the Labour Inspectorate to detect non-compliant behaviour by firms**. This option would involve directing the Inspectorate to scale up their proactive investigations in sectors where misclassification of employees is prevalent, in order to send a clear message that this behaviour will not be tolerated. This option may require more resources to be allocated to the Labour Inspectorate, as they currently do not have capacity to undertake additional proactive investigations. Maintenance of the law

[redacted]

[redacted].

58. **<u>Option 2</u> is to give labour inspectors the ability to make decisions about a worker's employment status**. The intention of this option would be to provide a low-cost, non-judicial pathway for workers to obtain a decision about their status. This would create a new function for labour inspectors, which would require additional resourcing to be effective. Asking inspectors to operate as a claims resolution service for individuals would be a change of approach for the regulator. Further policy design is needed to understand possible implementation options and appeal pathways.

59. As a further way to enhance the deterrence effect of regulatory action, **<u>option 3</u> is to introduce a specific breach for mispresenting an employment relationship as a contracting arrangement** (similar to the 'sham contracting' provisions in Australia's *Fair Work Act 2009*). Currently, the misclassification of workers is not a breach in its own right (although any associated failures to adhere to minimum employment standards would be breaches, and may attract penalties). Making misclassification a standalone breach would be likely to raise firms' awareness of the importance of classifying workers correctly, and to 'raise the stakes' for firms that get it wrong. This proposal relies on effective enforcement action, which is likely to increase costs for the regulator, employment institutions, and firms themselves. We will also need to work through whether such a breach should be actionable solely by labour inspectors, or whether employees and their representatives should also be able to take action regarding the breach.

60. As option 3 would create a new breach of employment standards, it would interact with existing accessory liability provisions allowing persons involved in a breach (such as company directors) to be held liable, and a new proposal in the consultation document 'Addressing Temporary Migrant Worker Exploitation' [DEV-19-MIN-0242]. Proposal One is to introduce liability for parties with significant control or influence over an employer that breaches employment standards. This could require those parties to take reasonable steps to ensure that employers they have significant control or influence over are not breaching employment standards, including by misclassifying their employees. The possible interaction of these two options is highlighted in the discussion document.

61. Key questions for consultation on options 1 - 3 include:

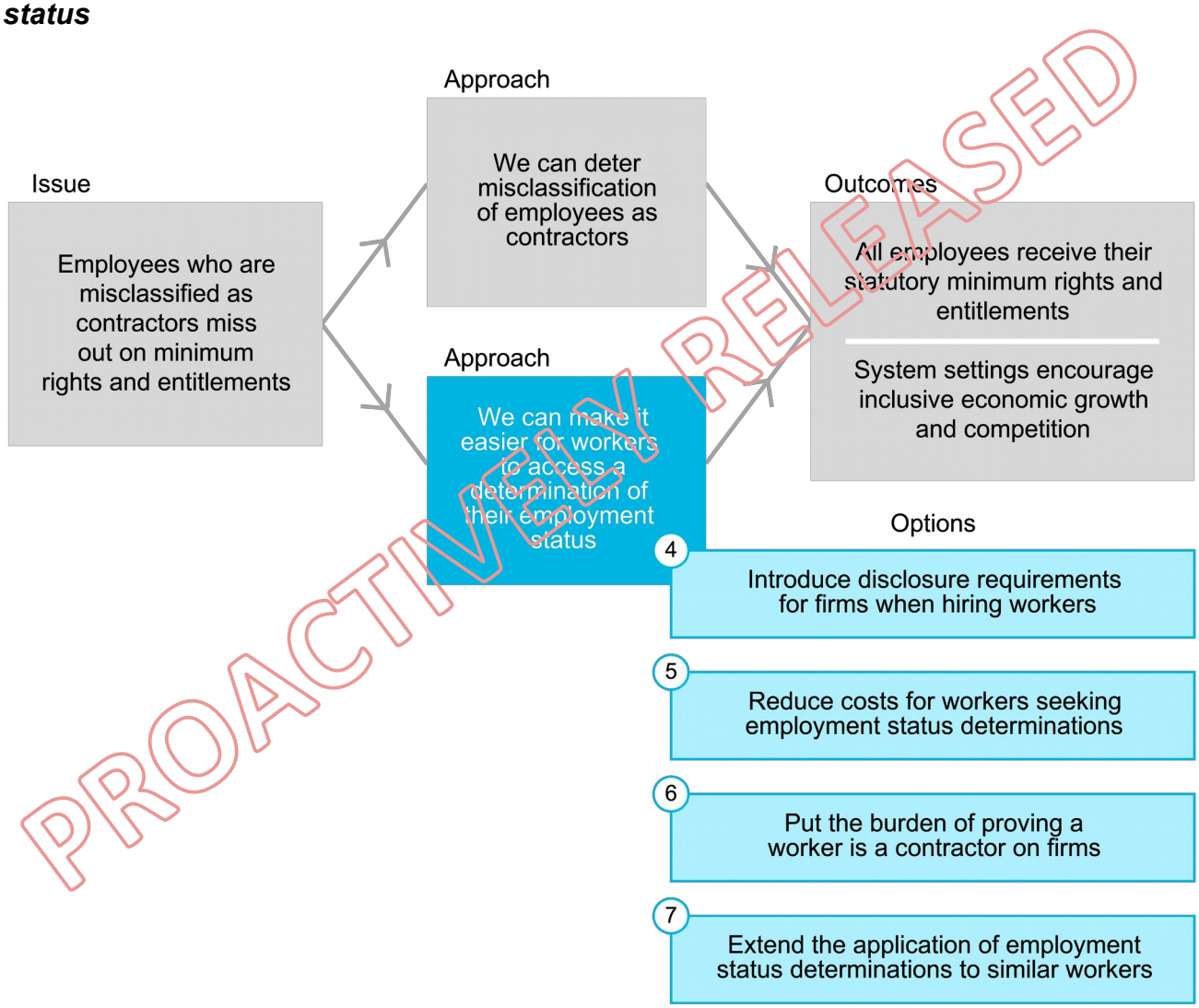
    **61.1.** whether stakeholders agree that misclassification should be a priority for investigation by the Labour Inspectorate – or if this should only be prioritised where there is also an element of exploitation (eg workers being treated as contractors *and* being paid less than the minimum wage)

    **61.2.** are there circumstances where labour inspectors should be able to challenge the way a firm is engaging its workforce, even if the workers themselves do not wish to pursue a complaint?

    **61.3.** is the employee-contractor boundary defined clearly enough for misclassification to be workable as a stand-alone breach?

**61.4.** if a specific breach is introduced, what is the standard of intentionality required? Should it apply to employers who claim they were confused about the law in this area? In Australia, the 'sham contracting' provisions give employers a defence if they can demonstrate a lack of intention or recklessness. This defence is considered by many commentators to be too broad, and it may undermine the effectiveness of a sanction.

***Options to make it easier for workers to access a determination of their employment status***






62. A range of factors may prevent misclassified workers from challenging their own employment status. Some have limited understanding of their rights and obligations, which could be exacerbated by the lack of documentation about the relationship. For other workers, challenging a firm's decision may not seem a realistic option. Disputing employment status may risk damaging (or ending) the working relationship. This prospect can be daunting, especially when workers have no obvious alternative employment opportunities (eg if a firm exercises a local monopoly).

63. It may be that regulator-led action (as in options 1 - 3 above) is the best way of reaching misclassified workers in these situations, rather than relying on workers taking action themselves. However, worker-initiated challenges are the cornerstone

of our current system, and it is vital that we make this pathway as accessible as possible.

64. One way to make it more likely for workers to challenge their status is to increase workers' awareness of how they are being engaged, and of the employment rights they may be foregoing when agreeing to work as a contractor. **Option 4 is to introduce disclosure requirements for employers when hiring contractors.** The information to be disclosed could include a statement about the worker being hired as a contractor, and a summary of the obligations that contractors have (this requirement would normally fall on an employer in an employment relationship).

65. Currently, the process of filing an application with the Authority or the court to determine the 'real nature of the relationship' is time-consuming and may require an expensive legal battle where legal aid is not easily accessible. The uncertainty, costs and time involved in taking legal action are seen as a high barrier for workers. There are a range of options that could be implemented (together or individually) to make status determinations more accessible.

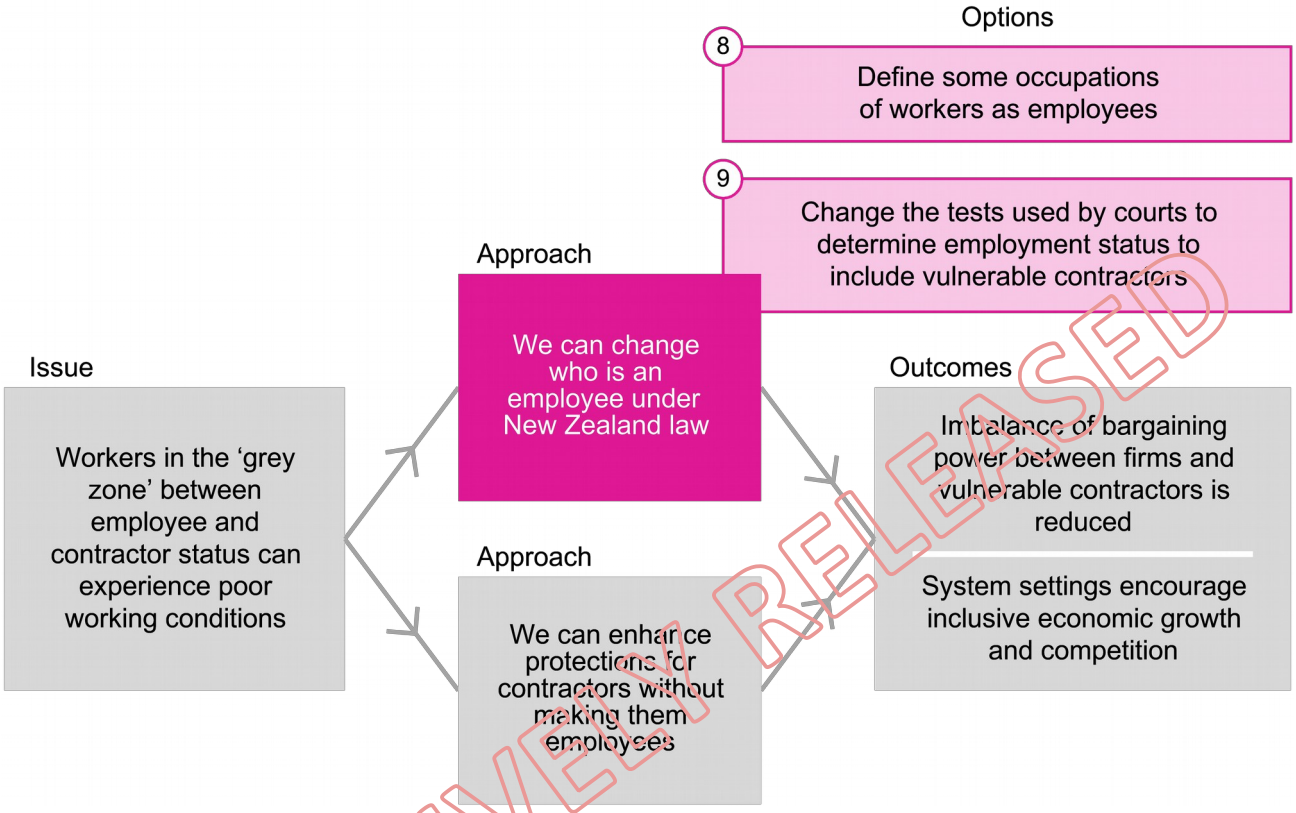
66. **Option 5 is to reduce legal costs for workers seeking employment status determinations.** This could be achieved by reducing or waiving the current fees for taking a status determination to the ERA, or improving access to low-cost legal advice and representation for contractors who want to take legal action because they believe they have been misclassified. I propose to test public views on the extent to which these costs currently function as a barrier for workers, and which particular costs should be borne by the state to have the biggest impact. If implemented, this option would require additional government funding for relevant agencies.

67. To reduce the time and uncertainty of the judicial process, I also consider there may be merit in exploring whether to weight the procedural requirements of employment status determinations in favour of workers. This may be particularly appropriate where workers are using the employment institutions as a means of accessing the basic labour protections enshrined in our law. I propose to test two options that could achieve this shift:

    **67.1. Option 6 is to change the legislation to put the onus of proving a worker is a contractor on firms (reversing the current burden of proof)**. This has been done in several European countries. This option could be designed to interact with option 2 (status determinations made by labour inspectors) and with prosecutions taken by inspectors under option 3 (to introduce a specific 'sham contracting' breach).

    **67.2. Option 7 is to extend the application of status determinations to go beyond the applicants themselves, and also apply to those who work for the same employer on fundamentally similar conditions**. I plan to test stakeholders' views on how feasible such 'extension orders' would be, and how they could be enforced.

***Options to change who is an employee under New Zealand law***






68. The case-by-case application of common law tests maximises flexibility for our courts when deciding questions of employment status. However, some stakeholders have raised concerns that judicial decisions do not always place enough emphasis on economic dependence or bargaining power imbalance. This means that even highly vulnerable workers may not be considered employees after the common law tests have been applied.

69. I propose to test two options that would increase the likelihood (to varying degrees) of dependent contractors being treated as employees. I note that, if these options were implemented, the flow-on effects on other agencies, including Inland Revenue, would need to be worked through carefully.

70. **Option 8 is to define some occupations or types of workers as employees (with opt-outs for individuals who can establish that they are genuinely operating as independent businesses)**. This approach would be consistent with the existing treatment of 'homeworkers' in the ER Act (who are specifically included within the section 6 definition of employee). This 'deeming' approach would maximise certainty about who is an employee for certain occupations or types of worker (eg youth aged under 16), but would reduce flexibility for firms and contractors. As well as seeking views on the degree of support for a change of this nature, the consultation document asks for feedback on how occupations could be selected for coverage.

71. **Option 9 is to expand the definition of employee by changing the 'real nature of the relationship' test – for example, by codifying the range of factors courts must consider**. This could include additional factors that would increase certainty for workers already misclassified, and increase the probability of employment law

remedies being available for workers in the current 'grey zone'. For example, the degree to which workers are economically dependent on one firm for the majority of their income over a certain period of time (eg over 80 per cent). Other additional tests could include:

**71.1.**

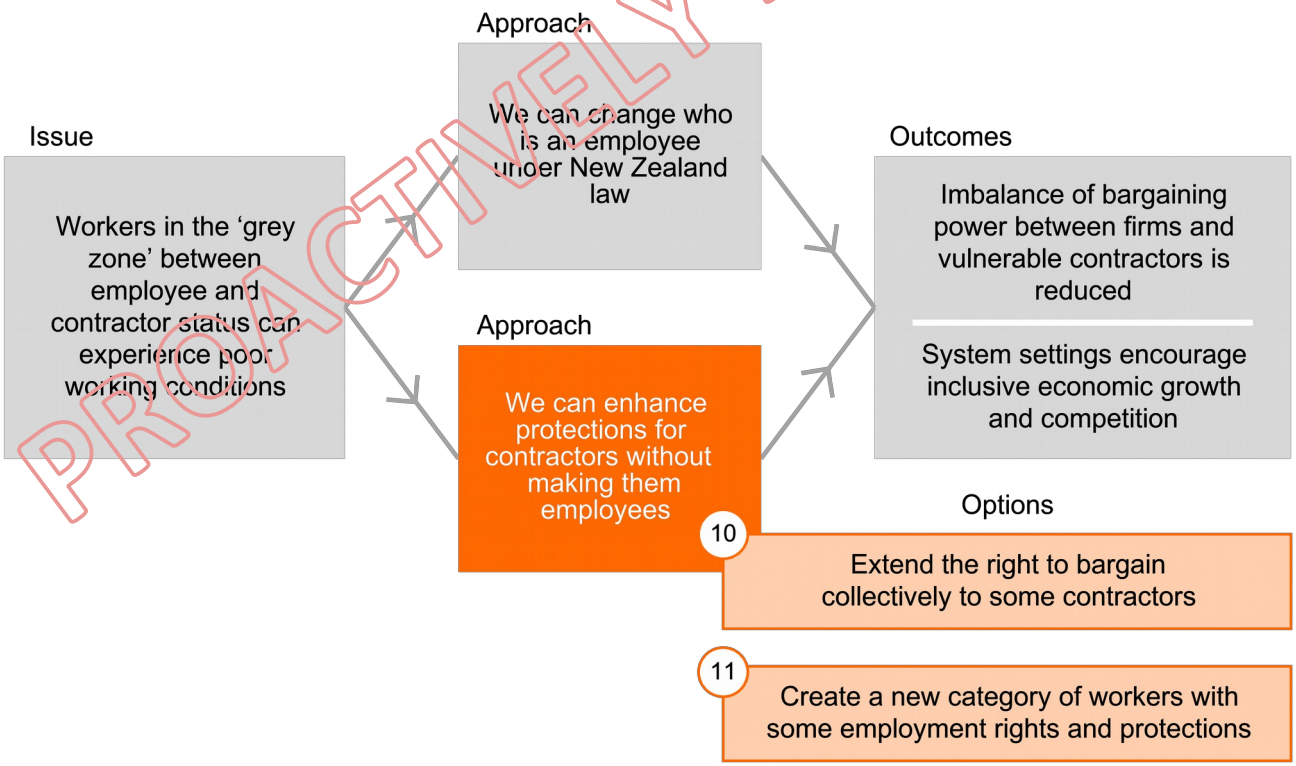
**71.2.** The bargaining power of the respective parties, which could be measured by market characteristics and the amount of information each party has.

**71.3.** Whether the worker ended up bearing a higher level of risk and cost than anticipated when they entered into the contract.

72. The tests could also be weighted, to give priority to certain criteria.

73. Options 8 and 9 both have risks in terms of limiting freedom of contract, and undermining the ability of firms to adjust workforce models flexibly. The consultation document highlights these risks and seeks feedback on how they could be managed.

***Options to enhance protections for contractors without making them employees***




74. The options in the final category recognise that workers in the current 'grey zone' (dependent contractors) may be genuine business people who may have no desire to access the full suite of employment rights (which would require them to assert a legal status that they do not identify with, and may not be compatible with their business goals). Nonetheless, the numerous reports of poor working conditions among contractors suggest that some changes could be warranted to enhance their bargaining power, and therefore reduce the likelihood of one-sided contracts being entered into.

75. **<u>Option 10</u> is to extend the right to bargain collectively to some contractors** (an approach that has been taken in Australia and Ireland). As with the sector-specific collective bargaining system we have agreed to for contractors in the screen industry, implementing this option would likely require changes to the *Commerce Act 1986*. This is because contractors are effectively treated as businesses, and collective bargaining can result in price fixing, output restrictions or otherwise substantially lessen competition, all of which is prohibited under that Act.

76. Initial analysis has identified two main avenues for allowing collective bargaining under the *Commerce Act:*

**76.1.** Create a 'safe harbour' exemption for collective bargaining unlikely to have competition detriments (a conditional exemption).

**76.2.** Extend the full existing Commerce Act exemption for employees to certain classes of dependent workers.

77. In my separate work developing a sector-wide collective bargaining system called Fair Pay Agreements [DEV-18-MIN-0100 refers, DEV-19-MIN-0266], I have signalled that I agree in principle that this system should include contractors as well as employees. This is consistent with the views of the FPA Working Group, who concluded that excluding contractors could create perverse incentives for employers to define work outside employment (i.e. to instead engage workers as contractors rather than employees).

78. However, I recognise that applying a sector-wide collective bargaining system to contractors will be a complex undertaking. Accordingly, the consultation document seeks feedback on whether an FPA system should be extended to contractors, and how this could be achieved. We will also canvass views on whether another framework to support collective bargaining by contractors (eg at enterprise or multi-enterprise level) could be created either in addition to the FPA system, or as an alternative.

79. Extending FPAs (or other forms of collective bargaining) could help mitigate power imbalances between groups of contractors and firms. Collective bargaining would allow groups of contractors to negotiate bespoke minimum standards (such as minimum remuneration, and holiday and sick leave) that are relevant and workable for their industry and circumstances, and that are more favourable to workers than the legislated minimum employment standards. I consider that introducing a duty of good faith alongside these changes could further help foster informed and productive discussion between the parties.

80. However, it is clear that this option is unlikely to benefit *all* vulnerable contractors – eg contractors in industries where bargaining capacity and capability is low to non-existent. Public consultation provides an opportunity to test stakeholders' views on the likely uptake of this option, and how best to manage the risk of price rigidity leading to sub-optimal outcomes for consumers. In developing this option further, I would work closely with the Minister of Commerce and Consumer Affairs.

81. Finally, **<u>option 11</u> is to create a new, third category of workers with some employment rights and protections (eg minimum remuneration protection) – in**

**between the employee and contractor categories**. This approach has been tried in a number of jurisdictions in recent years, with mixed success.

82. International experience shows that introducing a third category can lead to further confusion and misclassification. It can, for example, lead to there being two 'grey zones' instead of just one. Citing the experience of Italy, Slovenia and Spain, the OECD concludes that this option is likely to be the most difficult to implement in terms of defining this group of people, and determining the appropriate threshold for access and the rights that apply. It would also complicate administrative decisions by government agencies that are based on the contractor/employee distinction (eg taxation decisions by Inland Revenue).

83. For the reasons given above, I consider that the costs of this option are likely to outweigh the benefits. However, as this option is frequently cited in conversations about preparing for the 'future of work', I think there is merit in gauging public opinion on its applicability in New Zealand

**Public Consultation**

84. I consider that it is important to test the options for change with the public at this early stage, particularly given the potential impact on workers and firms. Public consultation will also assist officials to develop an effective implementation plan as part of the final policy proposal. To enable sufficient time for members of the public to provide feedback, I propose consulting for a period of six weeks, from 11 November until 20 December 2019.

85. Officials will also build in opportunities for specific consultation with key stakeholders, such as unions and worker groups, employers (targeting industries that would likely be affected by changes in this area) and Business New Zealand. I have asked that the consultation be designed so as to encourage participation by under-represented groups, including disabled people and ethnic communities. I intend to upload the text contained at Appendix 1 to an online platform to invite public feedback. Officials will also hold public engagement events to test the options for change.

86. If you agree to consult, I will provide my officials with any feedback arising from our discussion. The document will then be edited and designed for release. I recommend that you agree that I can make minor and technical changes (consistent with your decisions) to the proposals and the document as part of this final phase.

**Departmental Consultation**

87. The following departments and agencies were consulted, and their views are reflected in this paper as far as possible: Treasury, the State Services Commission, Inland Revenue, the Department of Prime Minister and Cabinet (PAG), Te Puni Kōkiri, Ministry for Pacific Peoples, WorkSafe, the Office of Disability Issues, the Office of Ethnic Communities, and the Ministries of/for Social Development, Justice, Women, Health and Education.

## Financial Implications

88. A number of the options I am proposing to consult on may have financial implications if they were implemented: for instance, they may require additional resources for the Labour Inspectorate and other employment services. If Cabinet agrees to consult the public on these options, my final policy proposal in April or May 2020 will set out any financial implications of the recommended approach.

## Legislative Implications

89. Most of the options I am proposing to consult on would require legislative change to implement. I will undertake the appropriate steps to seek a slot on the Legislation Programme and a priority category for any legislative change I may recommend to Cabinet in the future.

## Impact Analysis

90. The discussion document functions as an interim Regulatory Impact Assessment. MBIE's Regulatory Impact Analysis Review Panel has reviewed the discussion document and confirms that it is likely to lead to effective consultation and support the delivery of Regulatory Impact Analysis to inform subsequent decisions.

91. MBIE's Regulatory Impact Analysis Review Panel notes that while the problem definition could be clearer, and there is little description of potential costs and benefits of the proposals, the information gathered through the consultation process will address these gaps and inform the analysis of final policy proposals.

## Human Rights

92. The options outlined in this paper seek to have a positive impact on the maintenance of human rights. They would support the fair and consistent treatment of all workers in New Zealand, consistent with New Zealand's employment standards and rights. Further development of the options will also bear in mind the International Labour Organisation Recommendation on the Employment Relationship 2006 (No 198). Article 4(a) of that Recommendation recognises the legitimacy of self-employment and Article 8 states that national policy should not interfere with true commercial and civil relationships.

## Disability Perspective

93. It is likely that a proportion of the workers affected by the issues described in this paper will have a disability. Disabled people are already a vulnerable cohort with respect to realising their work and employment rights (disabled people are often over-represented in low-paid, low skilled employment) and, if they are also misclassified or 'dependent', then they face 'double discrimination'.

94. New Zealand is a party to the United Nations Convention on the Rights of Persons with Disabilities (UNCRPD). Article 27 of the Convention refers to 'work and employment' rights. Subject to the results of the consultation process, any measures to strengthen legal protections for vulnerable contractors should contribute to implementing the Convention.

## Publicity

95. If Cabinet agrees to the proposed consultation, I intend to make a public announcement shortly after Cabinet's decision.

## Proactive Release

96. This paper, along with the Cabinet minutes and any relevant supporting documentation, is proposed to be proactively released on MBIE's website within 30 working days of the final decision being made by Cabinet. The release of the information is subject to redactions consistent with the *Official Information Act 1982*.

## Recommendations

The Minister for Workplace Relations and Safety recommends that the Committee:

1. **note** that contractors are generally covered only by commercial law, and do not benefit from most statutory employment rights and protections – including the minimum wage, paid annual leave, and the right to bargain collectively

2. **note** that concerns have been raised about contractors' working conditions for many years – including in public submissions on the Minimum Wage (Contractor Remuneration) Amendment Bill in 2015 and 2016

3. **note** that stakeholders' concerns have focused on two interrelated issues:

    3.1. Workers that are in substance employees, but are misclassified as contractors by firms to reduce their entitlements

    3.2. 'Dependent contractors' who occupy a 'grey zone' between employee and contractor status, missing out on both the choice and flexibility associated with self-employment, and the legal protections afforded to employees

4 **note** that the Minister for Workplace Relations and Safety proposes to develop a comprehensive response to these issues, that:

    4.1. builds on steps the Government has already taken to better support contractors in the screen industry [DEV-19-MIN-0140] and curb unfair commercial practices [DEV-19-MIN-0189]

    4.2. recognises connections with consultations underway on work to combat temporary migrant worker exploitation [DEV-19-MIN-0242] and to develop a Fair Pay Agreement system, which would create a new mechanism for collective bargaining to set binding minimum wages and terms across an occupation or sector [DEV-18-MIN-0100, DEV-19-MIN-0266]

    4.3. situates the issues in a Future of Work context and seeks to future-proof the system.

5. **note** that addressing these issues would require legislative changes, and would be likely to require Budget funding to increase resources for the Labour Inspectorate and other employment institutions

6. **note** that the options identified are at an early stage of development, and public consultation at this stage will assist in:

   6.1. refining our understanding of the nature and scale of problems being experienced by contractors

   6.2. identifying benefits and costs as well as any feasibility issues with the options

   6.3. gauging the level of public support for changes in this area.

7. **agree** to publicly consult on the following options, which are not mutually exclusive and could be combined in various ways as a package:

   *Options to deter the misclassification of employees as contractors*

   7.1. Option one: increase proactive targeting by the Labour Inspectorate to detect non-compliant behaviour by firms

   7.2. Option two: give labour inspectors the ability to make decisions about a worker's employment status (this function currently sits with the Employment Relations Authority and Employment Court)

   7.3. Option three: introduce a specific breach for mispresenting an employment relationship as a contracting arrangement (similar to the 'sham contracting' provisions in Australia's *Fair Work Act 2009*)

   *Options to make it easier for workers to access a determination of their employment status*

   7.4. Option four: introduce disclosure requirements for employers when hiring contractors

   7.5. Option five: reduce legal costs for workers seeking employment status determinations

   7.6. Option six: change the legislation to put the onus of proving a worker is a contractor on firms (reversing the current burden of proof)

   7.7. Option seven: extend the application of status determinations to go beyond the applicants themselves, and also apply to those who work for the same employer on fundamentally similar conditions

   *Options to change who is an employee under New Zealand law*

   7.8. Option eight: define some occupations or types of workers as employees (with opt-outs for individuals who can establish that they are genuinely operating as independent businesses)

   7.9. Option nine: expand the definition of employee by changing the 'real nature of the relationship' test – for example, by codifying a range of factors courts must consider

*Options to enhance protections for contractors without making them employees*

7.10. Option ten: extend the right to bargain collectively to some contractors

7.11. Option eleven: create a new, third category of workers with some employment rights and protections – in between the employee and contractor categories

8. **note** that I intend to consult using the attached draft consultation document (Appendix One)

9. **agree** that I may make minor and technical changes to the proposals and the draft consultation document, consistent with Cabinet decisions

10. **note** that I propose a six week consultation period, from 11 November until 20 December 2019, which will include opportunities for workshops with key stakeholders

11. **note** that I intend to report back to Cabinet with final policy proposals in April or May 2020, and that this report will also set out any financial implications of the recommended approach.

Authorised for lodgement

Hon Iain Lees-Galloway

Minister for Workplace Relations and Safety