

SHAM ARRANGEMENTS AND THE USE OF LABOUR HIRE IN THE BUILDING AND CONSTRUCTION INDUSTRY

Discussion Paper prepared by the Australian Building and Construction Commissioner

**John Howe and Tess Hardy
Centre for Employment and Labour Relations Law**

Although the Discussion Paper prepared by the Australian Building and Construction Commissioner identifies a number of interesting and pertinent problems and challenges in relation to sham contracting, we will confine this submission to some comments and suggestions in relation to two issues: first, enforcement of regulation generally; and second, the adequacy of the regulatory framework relating to sham contracting and in particular, labour hire arrangements.

General Comments regarding Regulation and Enforcement

1. In making this submission, we draw on our knowledge of approaches to this issue in other countries and the international empirical literature on 'best practice' in regulation and enforcement.¹ This literature is a source of evidence-based information on what approaches to regulation and enforcement are most effective, efficient, legitimate and practical. While much of this literature relates to policy areas other than sham contracting, we have identified some relevant findings which we detail in our submission.
2. As a preliminary, it is worth underlining the importance of the Discussion Paper and the proposed Roundtables in gathering critical information about the industry and the motivations and pressures placed on employers and workers to enter into sham contracting arrangements. Understanding these drivers is crucial for tailoring an enforcement strategy that works to reduce the prevalence of these arrangements in the long term. In particular, Professor David Weil, a US economist, has argued that strategic enforcement requires addressing the underlying factors that lead to employer non-compliance, such as sham contracting arrangements. In other words, regulatory strategies and tools should be aimed at changing the behaviour of employers at the market level, rather than at the level of the individual workplace.²
3. It is equally important that within the building and construction industry, the Australian Building and Construction Commission (ABCC) seeks to identify those sub-sectors which have large numbers of vulnerable workers and where sham contracting is most common and most exploitative. In this respect, we note the comments of the Commissioner, who has recently observed that his 'principal concern from a regulatory

¹ This is a voluminous literature, but an example of particular relevance is David Weil, 'Improving Workplace Conditions through Strategic Enforcement' (Report to the Wage and Hour Division, US Department of Labour, May 2010). See also Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992); Bridget Hutter, 'Variations in Regulatory Enforcement Styles' (1989) 11 *Law & Policy* 153; and Robert Baldwin and Julia Black, 'Really Responsive Risk-Based Regulation' (2010) 32(2) *Law & Policy* 181.

² Weil, above n 1, 75.

perspective is in relation to the finishing trades – painting, plastering, formwork and those types of trades...’³

4. All the strategies identified in the Discussion Paper and this submission including education initiatives, complaint response, targeted investigations, collaboration with labour market intermediaries and other government agencies, and use of litigation must be linked and coordinated so that they help create a regulatory environment that encourages systemic, sustainable compliance and most effectively deter those who seek to enter into sham contracting arrangements.⁴

Labour Hire Arrangements

How could the ABCC assist all stakeholders in the building and construction industry to ensure that labour hire practices are both fair and efficient?

5. The ABCC could assist stakeholders by advocating for the licensing or registration of labour hire employers operating in the Australian building and construction industry.
6. The licensing model under the *Gangmasters (Licensing) Act 2004* (UK) provides a useful example of how a licensing regime, coupled with an increased focus on enforcement, has the potential to improve compliance amongst labour hire providers. The gangmasters' licensing scheme stipulates compliance with a set of licensing standards administered by the Gangmasters Licensing Authority. Labour hire providers must meet these standards in order to qualify for and retain a license to operate in the regulated industries. To obtain a license, the relevant regulations require the applicants to demonstrate that they comply with a range of legal obligations including VAT registration, payment of wages, tax, national insurance and health and safety.
7. It is not only the licensing process itself which constitutes an effective method of scrutiny, but also the range of sanctions available to the regulator under this regime. For example, the Gangmasters Licensing Authority has the power to refuse or revoke a license or grant a license only on specific conditions. In addition, some offences carry custodial penalties up to 10 years imprisonment.⁵ It is generally accepted that enhancing the suite of sanctions available to the regulator is a vital part of responsive regulation.⁶

Is the concept of joint employment worthy of further exploration in the context of the building and construction industry?

8. In relation to the question of whether the concept of joint employment is worthy of further exploration in the context of the building and construction industry, we draw the Commissioner's attention to the following study: C Dowling, *The Concept of Joint Employment in Australia and the Need for Statutory Reform*, (LLM Thesis, University

³ Evidence to Senate Standing Committee on Education, Employment and Workplace Relations, Parliament of Australia, Canberra, 23 February 2011, (Mr Leigh Johns) 98.

⁴ Weil, above n 1, 78.

⁵ For further discussion of the regulation of employment agencies in the UK see: M Wynn, 'Regulating rogues? Employment agency enforcement and sections 15-18 of the Employment Act 2008' (2009) 38(1) *Industrial Law Journal* 64.

⁶ See generally Ayres and Braithwaite, above n 1.

of Melbourne, July 2008). Drawing on statutory recognition of joint employment in the United States of America, the thesis proposes a definition for statutory recognition of joint employment in Australia with the aim of protecting vulnerable labour hire workers.

The Regulatory Framework in the Building and Construction Industry

What alternatives to litigation, if any, could and should the ABCC use to address the problem of sham contracting in the building and construction industry?

9. It is generally accepted amongst regulatory theorists that ‘the most credible and optimal enforcement strategy is achieved by a judicious mix of deterrence and persuasive approaches being applied in a regulatory enforcement pyramid.’⁷ While litigation is an important sanction, it is equally essential that there is a hierarchy of lesser punishments at the regulator’s disposal.
10. We note that other sanctions available to the FWO, but not the ABCC, include compliance notices, enforceable undertakings and infringement notices. These alternative enforcement mechanisms could be a valuable addition to the regulatory toolbox of the ABCC. As noted above, the introduction of a licensing regime for labour providers could provide another method by which to achieve general and specific deterrence.
11. The way in which litigation is used as an enforcement mechanism is also vital to addressing the problems of sham contracting. Weil has argued that rather than focus on violations at the firm level, it is important to understand the interconnection between the various entities and direct enforcement strategies which target organizations located at higher levels of industry structures. This is particularly important in light of the high rates of and problems associated with fraudulent phoenix companies.⁸

How could the ABCC encourage workers and employers affected by sham arrangements or unfair contracts to come forward?

12. The Discussion Paper rightly points out that there are various obstacles in relation to investigating and prosecuting sham or unfair contracting. Such obstacles include: ‘potential complainants choosing not to approach a regulator for assistance for fear that their own taxation and business arrangements will come under scrutiny; and workers not being sufficiently aware of their rights under the FW Act and IC Act to complain to a regulator.’⁹ The structural barriers which militate against the making of complaints are of some concern given that, historically at least, the ABCC has relied heavily on a complaints-based inspection strategy.¹⁰

⁷ Liz Bluff and Richard Johnstone, ‘Infringement Notices: Stimulus for Prevention or Trivialising Offences?’ (2003) 19 *Journal of Occupational Health and Safety* 337, 338.

⁸ Discussion Paper, 29-30.

⁹ Discussion Paper, 56.

¹⁰ For example, when questioned before the Senate Estimates Committee as to why cases involving underpayment and sham contracting were significantly less prominent than those involving union contraventions, the previous Australian Building and Construction Commissioner, Mr John Lloyd, confirmed that the focus of investigations generally reflected the complaints made to the ABCC. See Evidence to Senate Standing Committee on Education, Employment and Workplace Relations, Parliament of Australia, Canberra, 3 June 2008 (Mr John Lloyd) 105.

13. In a study of complaint activity in the United States, Weil and Pyles found that the frequency of complaints in any given industry or sector does not necessarily correlate with the highest rates of workplace contraventions. Rather, they argue that the question of whether a worker exercises their right to complain under workplace laws often turns on the perceived benefits versus costs of exercising that right.¹¹ Such costs generally include those associated with gathering information on the relevant workplace rights and standards and how they are administered. There are also the perceived costs arising from employer retaliation, which can include reduction of shifts, withdrawal of work and/or termination of the engagement.¹² In the context of sham contracting arrangements, workers face the additional cost of investigation and prosecution by other regulatory agencies, such as the Australian Tax Office (ATO).
14. We are concerned that identification of sham contracting arrangements is problematic because of the various structural barriers which prevent workers bringing such arrangements to the attention of the regulator. There are also various incentives, such as tax avoidance or minimisation, which can lead to less self-reporting. As there is limited job security and work is often sporadic, employees fear that refusing to accept a labour hire arrangement or complaining about the terms of the arrangement may lead to loss of work. Often, there are very few remedies or protections available in these circumstances.
15. We note that the Discussion Paper did not specifically refer to the unique enforcement challenges posed by foreign or migrant workers engaged in the building and construction industry. This issue has not, however, escaped the unions' attention.¹³ In particular, the Construction, Forestry, Mining and Energy Union (CFMEU) has previously claimed that sham contracting arrangements were widespread in the building and construction industry and that overseas workers were 'most vulnerable to exploitation.'¹⁴ The Minister for Tertiary Education, Skills, Jobs and Workplace Relations has also recently raised concerns about exploitative practices involving foreign workers.¹⁵ Furthermore, in the last financial year, construction was in the top three industries for primary section 457 visa grants.¹⁶
16. These developments are troubling, particularly in light of the fact that workers who feel exposed to exploitation are less likely to complain.¹⁷ In addition to foreign and migrant workers, other vulnerable workers include those with less education or fewer skills or those engaged in smaller workplaces or sectors with low levels of union representation.¹⁸ To encourage these groups to come forward, the ABCC should ensure that it strongly pursues any person who seeks to intimidate or discriminate against a worker who has lodged a complaint about sham contracting arrangements.

¹¹ David Weil and Amanda Pyles, 'Why Complain? Complaints, Compliance, and the Problem of Enforcement in the US Workplace' (2005) 27 *Comparative Labour Law and Policy Journal* 59, 64.

¹² *Ibid* 64-65.

¹³ See, eg, CFMEU, 'Foreign Workers Exploited, Aussie Workers Missing Out', <<http://www.cfmeu.asn.au/news/foreign-workers-exploited-aussie-workers-missing-out>>.

¹⁴ 'ABCC should pay more attention to underpaid workers: CFMEU', *Workplace Express*, 8 October 2009.

¹⁵ 'Government seeks briefing on 457 visa breaches', *Workplace Express*, 17 February 2011.

¹⁶ 'Subclass 457 Business (Long Stay): State/Territory Summary Report – 2009/2010', *Department of Immigration and Citizenship*.

¹⁷ Weil and Pyles, above n 12.

¹⁸ Weil, above n 1, 76.

17. Furthermore, given that the regulatory emphasis of the ABCC has undergone a significant shift in the recent past, it is arguable that more needs to be done to ensure that firms and workers properly understand the role that the ABCC now plays. This is especially important in light of a previous case where the regulator was openly criticised for pursuing claims involving union contraventions at the expense of those involving sham contracting arrangements.¹⁹
18. Ultimately, however, the regulator must be careful not to rely on complaints alone. While a previous audit undertaken by the ABCC appears to have been of limited utility,²⁰ there is a strong body of evidence to suggest that targeted audit campaigns are an important regulatory strategy and should be used to supplement complaint-based inspections.²¹ To improve the effectiveness of such campaigns, the regulator must proactively seek access to relevant information about business structures and 'hot spots'. In this respect, building relationships with industry stakeholders is critical.

What more could and should the ABCC do to provide education and information about sham contracting and unfair contracts in the building and construction industry?

19. A key to improving the dissemination of information and reducing the costs associated with complaining is to utilise a collective workplace agent. In the Australian building and construction industry, the most obvious collective workplace agents are the relevant unions. However, their cooperation in the enforcement enterprise is somewhat doubtful given that most unions have been openly hostile towards the ABCC. For instance, a CFMEU representative has previously stated that 'it should not be up to the union to provide [the ABCC] with evidence of alleged abuses.'²²
20. While advice and education are important, particularly in proving that the employer has knowingly or recklessly entered into a sham contracting arrangement, it can only go so far in preventing these arrangements from proliferating. There are simply too many incentives for firms and workers to enter into sham contracting arrangements. Ultimately, the prospects of detection must be improved and sanctions more readily imposed. In this respect, it is promising to note recent reports that, in relation to sham contracting, the ABCC now has 14 investigations underway and 19 briefs have been referred to its legal department.²³ Late last year, the ABCC also launched its first case under the federal sham contracting provisions.²⁴ It is hoped that this regulatory momentum continues.

¹⁹ 'Even-handed construction cop wouldn't have turned a blind eye to dishonest, black economy employer, says judge', *Workplace Express*, 10 October 2008.

²⁰ 'ABCC pressed on sham contracting', *Workplace Express*, 22 October 2009.

²¹ See Weil, above n 1. See also Miles Goodwin and Glenda Maconachie, 'Transforming the inspection blitz: targeted campaigns, enforcement and the Ombudsman' (2010) 21(2) *Labour & Industry* 369.

²² 'ABCC should pay more attention to underpaid workers: CFMEU', *Workplace Express*, 8 October 2009.

²³ Evidence to Senate Standing Committee on Education, Employment and Workplace Relations, Parliament of Australia, Canberra, 23 February 2011 (Mr Leigh Johns) 98.

²⁴ 'ABCC targets alleged sham contractor', *Workplace Express*, 6 September 2010

In what ways could the ABCC and the FWO cooperate more effectively to reduce the incidence of sham contracting and unfair contracts in the building and construction industry?

21. There is a real need for the sharing of information and joint enforcement initiatives between the ABCC and the FWO, as well as all other relevant regulatory agencies, including the ATO, ASIC, DIAC and state-based OHS and workers' compensation bodies. While these agencies have a distinct mandate and agenda, they all have an interest in ensuring that sham contracting arrangements are detected and curtailed.
22. Information-sharing can lead to better targeting of sub-sectors and firms. There are also real opportunities for cross-agency diffusion of skills and experience, particularly in light of the recent initiatives undertaken by the ATO. However, joint initiatives and information-sharing is resource intensive and requires the commitment of senior management of the various organisations, particularly when issues arise (such as where the investigation procedures of one agency conflicts with another). The appointment of a joint taskforce committee can be a useful way of overcoming some of these challenges.²⁵
23. Finally, to the extent possible, the ABCC should seek to collaborate with employer associations and unions in gathering information and conducting joint investigations. We note that the ABCC has already made it clear that it is keen to cooperate with unions in relation to sham contracting, amongst other matters.²⁶ Indeed, in other countries, collaborative arrangements between the regulator and construction unions have produced a number of positive outcomes. For example, for over 10 years, the Los Angeles Unified School District has run a program under which trade union representatives are trained and officially authorised to undertake inspections to check compliance with minimum wage standards on district construction projects. Since 2004, the Los Angeles Board of Public Works has administered a similar program. According to the study by Janice Fine and Jennifer Gordon, both programs seek to make the union representatives 'the "eyes, ears and foot soldiers" of city inspectors'.²⁷ Not only have these programs improved the likelihood of detection, but there has also been anecdotal evidence that the role played by unions had led to a significant increase in compliance.²⁸ Similarly, employer associations can also be important enforcement agents and often have an interest in working with the regulator to stamp out rogue behaviour. We appreciate, however, that given the relatively turbulent state of relations between the regulator and the relevant stakeholders, it may be difficult, if not impossible, to undertake these types of collaborative arrangements in the Australian context, at least for the foreseeable future.²⁹

²⁵ Weil, above n 1, 92.

²⁶ 'Workers end strike as ABCC opts for pledge over prosecution', *Workplace Express*, 10 February 2011.

²⁷ Janice Fine and Jennifer Gordon, 'Strengthening Labor Standards Enforcement through Partnerships with Workers' Organizations' (2010) 38 *Politics & Society* 552, 563.

²⁸ *Ibid* 565.

²⁹ In this respect, we note that the Independent Contractors Association and the CFMEU have both publicly announced that they will not be making formal submissions to the Sham Contracting Inquiry. See Independent Contractors Association, 'Warning: ABCC inquiry and shams' <<http://www.contractworld.com.au/icact/ica-warning-ABCC-inquiry-and-shams.php>>.