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# "Lord of the Rings" clarifies the independent contractor/employee divide

**Presentation to Public Sector Lawyers**

**December 2004**

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# "Lord of the Rings" clarifies the independent contractor/employee divide

Many independent contractors work in the public and private sectors. Often they come close to employee status. Whether someone is an employee or a contractor is significant. In this article, we deal with the Lord of the Rings case that clarifies the position. The new law, as interpreted by the Court of Appeal, means parties can't rely largely on what their contract states: they must also consider a wider array of factors which makes the task of deciding whether someone is an employee or contractor more difficult.

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## 1. Introduction and Summary

1.1 Many independent contractors work in the public and private sectors. Often they come close to employee status. Whether someone is an employee or a contractor is significant. Of course, an employee comes within the employment law regime. There are tax implications as well. For example, a contractor, failing to pay provisional tax, who is later determined to be an employee, could drop the employer into unexpected PAYE exposure.

1.2 Whether someone is engaged under a contract of *service* (employee) or *services* (independent contractor) can be a difficult question. Often, it is not capable of a black and white answer.

1.3 There is an array of tests for deciding if someone is a contractor or an employee. In *TNT v Cummingham*[1], the Court of Appeal in 1993 emphasised the following points, for determining whether someone is an employee or an independent contractor:

1.3..1 Respect for contractual form (unless the contract is a sham);

1.3..2 Acceptance of the choice made by parties

1.3..3 Rejection of a pro-employment bias[2]

1.4 In short, the parties' choice was particularly significant in deciding the status of the person (ahead of the underlying reality of the relationship). Not surprisingly, there was some concern that employers could use the contractor model to worm out of employment law obligations. In response to *TNT*, Section 6 of the Employment Relations Act 2000 changed the law. In deciding whether someone is an employee or a contractor, the *"real nature of the relationship"* must be determined. *"Any statement by the persons that describes the nature of their relationship [is not] a determining matter…".*

1.5 In November 2004, the Court of Appeal considered this change for the first time. The case is *Three Foot Six Limited v Bryson*[3]. The Court decided that section 6, (in their words) only "*nudges*" the law away from where it stood before 2000. In particular, the existing array of tests for determining whether someone is an employee or an independent contractor remains. What the parties say in their contract takes a lower, yet still important, status.

1.6 The case involved the film industry. In the special circumstances of that industry, it was decided that Mr Bryson was an independent contractor, not an employee, even though in many ways the nature of his position accorded with employment status.

1.7 This was a majority decision and it was a close call. That emphasises how hard it is to decide in many cases whether someone is an employee or a contractor.

1.8 It would be highly inappropriate and risky for any organisation (whether public or private sector) to push the boundaries on whether someone is an independent contractor or an employee. Having noted that however, risk is relatively low as, generally, neither party has any interest in rocking the boat.

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[1] [1993] 1 ERNZ 695
[2] This is how the majority of the court in *Three Foot Six Ltd v Bryson* (Court of Appeal 246/03; 12 November 2004 para 69) summarised the *TNT v Cunningham* decision.
[3] (Court of Appeal 246/03;12 November 2004)

1.9 This area of the law is so grey that there will always be an element of risk where independent contractors are taken on, particularly on a relatively long term "bums on seats" basis rather than a project basis.

1.10 The new law, as interpreted by the Court of Appeal, means parties can't rely largely on what their contract states: they must also consider a wider array of factors which makes the task of deciding whether someone is an employee or contractor more difficult.

## 2. Jim Bryson's hobby

2.1 Jim Bryson liked making models. He was able to make a living out of his hobby. From 1998 to 2001, he worked on *The Lord of the Rings* trilogy, first for Weta Workshop and then for Three Foot Six Ltd, the company formed to produce the trilogy. He worked for that company from April 2000 to September 2001, when his engagement was terminated. He claimed employment law remedies.

2.2 Bryson and Three Foot Six Ltd had signed an agreement which called him an independent contractor (i.e. employment law wasn't to apply). In most other respects, his contract was equally consistent with an employment contract. So was his work: he worked standard hours, got paid overtime, did work that was determined and vetted by Three Foot Six, and he mainly used tools supplied to him.

2.3 A decisive fact in the case was that independent contractor status is ubiquitous in the film industry for a number of reasons including: the possibility of a project being terminated at any time; constant fluctuation of people requirements; and the short term nature of many productions[4].

## 3. Pre-2000 Employee/Contractor Tests

3.1 Up to 2000, there were three main tests for deciding the employee/contractor question after the new legislation was introduced. The Court of Appeal has confirmed that they continue to apply. They are the "*fundamental*" test, the "*control*" test and the "*integration*" test.[5]

3.2 "*Fundamental*" in the sense that the fundamental question is said to be *"…is the person who has engaged himself to perform these services performing them as a person in business on his own account? If the answer to that question is "yes" then the contract is a contract for services [independent contractor]. If the answer is "no" then the contract is a contract for service [employee]."*

[4] *Three Foot Six Limited* para 55.
[5] For more detailed recent summaries of these tests see the *Three Foot Six decision* and also the 12 October 2004 NZLS Employment Law Conference paper at page 305.

3.3 A number of factors are taken into account under this "*fundamental*" test including;

3.3..1 Did the person provide her own equipment?

3.3..2 Did she hire her own helpers?

3.3..3 What degree of financial risk did she take?

3.3..4 What degree of responsibility for investment and management did she have?

3.3..5 Did she have an opportunity for profiting from sound management in the performance of the task?[6]

3.4 The "*control*" test revolves around whether the "*employer*" directed not only what work was to be done but the manner in which it was to be done. However, the fact that the "*employer*" has close control over the person's work does not necessarily mean that he or she is not an independent contractor. This was emphasised by the Court of Appeal in *TNT v Cunningham*.

3.5 The "*integration*" test deals with whether the person was his "*own person*" or part of the business organisation. The more integrated the person is in the business, the more likely it is that he or she will be an employee.

3.6 As noted above, how the parties choose to treat their relationship, (i.e. what the contract says, what they did about PAYE, etc), at least before 2000, was a major if not dominating factor.

## 4. What difference does the 2000 Act make?

4.1 In *Three Foot Six Ltd*, the Court of Appeal canvassed the legislative process leading up to the new Act. The Court decided that the change was relatively light handed, when Parliament had a choice to send a stronger message that the contract should have less prominence than it had before 2000:

> *"We consider that the phrase "real nature of the relationship" in s6 is not just a short-hand for the result of an analysis based solely on the control and integration tests or the fundamental test applied primarily by reference to the control and integration tests. If that is what Parliament intended, it could easily have said so….The terms of s6 (especially when considered in light of the relevant Parliamentary history) suggest that a more open-textured enquiry is necessary."*[7]

[6] See 12 October 2004 NZLS Employment Law Conference paper at page 305.
[7] *Three Foot Six Ltd* at para 101.

> *"So we are prepared to accept that s6 of the Employment Relations Act proceeds on the basis that "the real nature of the relationship" is not controlled by contractual terms and this is so even in cases where the contractual form adopted by the parties cannot be stigmatised as a sham….On the other hand, such terms are not relegated to the status of secondary considerations…."*[8]

4.2 So the legislation does not radically alter the existing regime. Rather, as the Court of Appeal said, it nudges the regime away from the dominance of the contract to more open-textured considerations, including the terms of the contract.

4.3 This may make deciding whether someone is an employee or a contractor even harder (as in many cases the contract itself won't provide a ready answer).

4.4 The unique feature in *Three Foot Six* is the ubiquity of independent contractors in that industry. This is where the majority and minority of the Court of Appeal differed. The majority saw this as highly relevant and decided that Bryson was an independent contractor. The minority (McGrath J) held that this industry-wide practice should not be determinative in an employment context. It's important to emphasis that very few sectors will have such a widespread practice. Therefore, this factor for deciding a case will only rarely be relevant in practice.

## 5. Tax

5.1 Whether someone is an employee or an independent contractor of course has PAYE, GST, provisional tax, and other tax implications. The IRD applies the same tests for deciding whether someone is an employee or a contractor.[9] IRD can be expected to tweak its approach, based on the *Three Foot Six* approach.

## 6. Fixed Term Agreements

6.1 It is worth mentioning these in passing. Having an agreement by which employment can be terminated early is one mechanism by which long term employment obligations are avoided. However, as can be expected, the employment legislation is drafted to make sure that there have to be genuine reasons for this approach, so that employee's rights are not lost.[10]

## 7. Conclusion

7.1 It would be highly inappropriate and risky for any organisation (whether public or private sector) to push the boundaries on whether someone is an

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[8] Para 105-106.
[9] See http://www.ird.govt.nz/otherservices/adjudicationrulings/interpretation/ig0009.pdf and http://www.ird.govt.nz/library/newsletters/tib/vol11/tib11-02.pdf
[10] Section 66 Employment Relations Act 2000.

independent contractor or an employee. Having noted that however, risk is relatively low as, generally, neither party has any interest in rocking the boat.

7.2 This area of the law is so grey that there will always be an element of risk where independent contractors are taken on, particularly on a relatively long term "bums on seats" basis rather than a project basis.

7.3 The new law, as interpreted by the Court of Appeal, means parties can't rely largely on what their contract states: they must also consider a wider array of factors which makes the task of deciding whether someone is an employee or contractor more difficult.

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