Wednesday, October 27
9:00am-10:30am

906 - Using Independent Contractors and Other Contingent Workers: A Slippery Slope Getting Slipperier?

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Session 906

Faculty Biographies

Ann Fromholz

Ann Fromholz is senior counsel in the Corporate, Employment & Procurement group of ConocoPhillips' legal department. She focuses on all areas of employment law, including wage and hour compliance, employment policies, wrongful termination, employment discrimination, harassment, leave law issues, and employee discipline and discharge. Ms. Fromholz also works in the areas of data privacy and employee privacy. She is a member of ConocoPhillips' Retention Committee, which sets document retention policy, oversees retention and destruction processes, and approves exceptions.

Before joining ConocoPhillips, Ms. Fromholz was senior counsel at Kaiser Permanente and, prior to that, was a labor and employment partner in the Los Angeles office of Seyfarth Shaw LLP.

Ms. Fromholz serves as the co-chair of the ABA Labor and Employment Law Section's Marketing Committee and is a member of the planning committee for the ABA National Conference on Equal Employment Opportunity Law. She serves as the secretary of the Dartmouth Lawyers Association. She also is a member of the board of directors of the Junior League of Houston, Inc.

Maryrose Maness

Maryrose E. Maness is currently vice president and chief employment counsel for Warner Music Inc., where she leads the employment, benefits, trademarks, and records management practice groups.

Ms. Maness began her career in law with Grotta, Glassman and Hoffman (now known as Fox Rothschild), a boutique law firm specializing in labor and employment law. Prior to joining Warner Music, Ms. Maness was senior assistant general counsel for Altria Client Services Inc. where she led the employment and benefits practice and managed lawyers in multiple practice areas including records management, IT, aviation, finance, facilities, risk management and data privacy. Ms. Maness also spent two years as chief employment and labor council for Melville Corporation.

Ms. Maness has successfully negotiated labor contracts for a variety of industries and employment contracts for key executives; she has also supervised complex and potentially large exposure employment litigation and provided advice and counsel for several large workforce reduction programs. She is currently employment chair and vice president of the greater New York chapter of the Association of Corporate Counsel. Ms. Maness has also served as a lecturer for ACC and council on education in management.

Ms. Maness received her law degree from Seton Hall School of Law.

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Ms. Fromholz received a BA from Dartmouth College and a JD from the University of Southern California Law School.

Carl Omohundro

Buddy Omohundro is senior vice president, general counsel, principal for Apex Systems, Inc. in Richmond, Virginia. Apex Systems, Inc. is the ninth largest information technology staffing provider in the United States and ranks in the top one percent of all staffing companies. As Apex's chief legal officer and a member of its senior management council, Mr. Omohundro manages and advises the company on a broad range legal and business issues in numerous areas, including litigation, employment, immigration, contract negotiation, compliance, security, corporate governance, mergers and acquisitions, real estate, insurance, and intellectual property.

Before joining Apex, Mr. Omohundro practiced law in the labor and employment department with McGuireWoods in Richmond, and served as law clerk for the Honorable Elizabeth B. Lacy of the Supreme Court of Virginia.

Mr. Omohundro has presented and participated as a panelist on a variety of business and legal topics for a number of organizations, including, most recently, the National Association of Computer Consultant Businesses. Mr. Omohundro received national media attention in 2005 after discovering the Virginia General Assembly's inadvertent repeal of a list of exemptions from the Commonwealth's "Day of Rest" statute, requiring then Virginia Governor Mark Warner to call a special session of the general assembly for the sole purpose of correcting the error.

Mr. Omohundro received a BA from the University of Virginia. He received a JD, magna cum laude, and his Master of Business Administration, with honors, from the University of Richmond.

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Overview

Leased Workers

- The U.S. Department of Labor reported in November 2009 that 44,000 temporary jobs have been added since this time last year.
- Difficult to estimate the total number, but it appears to be growing.

Independent Contractors

- In 2005, nearly 10.3 million workers (7.4% of the employed workforce) were classified as independent contractors.
- The number of independent contractors who are properly classified is probably far less.

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Overview

- A study by the U.S. Department of Labor found that between 10% and 30% of the employers audited were found to have misclassified workers.
- The same study reported that in some states, 95% of workers claiming that they were misclassified were reclassified as employees following a review.
- The IRS estimates that it is losing $20 billion a year due to worker misclassification.

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Why Worry?

- A crackdown on misclassification by federal and state agencies has been anticipated for several years now.
  - Obama's $25 million "Misclassification Initiative"
  - Dept. of Labor announced that it will hire 100 additional investigators
  - Joint proposal by DOL and DOT to penalize employers who misclassify
  - Taxpayer Responsibility, Accountability, and Consistency Act of 2009 - increase penalties for filing incorrect employment tax information on tax returns
  - The Employee Misclassification Protection Act of 2010
  - IRS announced that it will launch a program to randomly audit over 6,000 companies in 3 years
  - President Obama anticipates $7 billion in additional revenue in next 10 years
  - States cracking down as well – Delaware, Maryland, Pennsylvania

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Leased Employees

- Workers who are (1) hired for contingent work, (2) paid according to hours worked, and (3) draw no benefits that are commonly available to the regular employees.
- Terms used:
  - Leased employee
  - Temporary employee
  - Contingent worker
  - Contractor
  - Contract Employee
  - Consultant
  - Freelance worker
  - Seasonal worker

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Independent Contractors

- Self-employed workers who provide certain services to a second-party, or to a third-party on behalf of a client. Independent contractors are not under the control, guidance or influence of the client.
- Terms used:
  - Independent contractors
  - 1099s
  - Corp-to-corp

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What are the Benefits?

- **Leased Workers**
  - Uncertain about future growth of company.
  - Training, HR, payroll often handled by the staffing firm
  - Often less expensive than hiring a regular employee – particularly for a short-term project.
  - Most leased workers do not receive other employment benefits (i.e., health insurance, pension, paid sick leave, etc.)

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What Are The Benefits?

- **Independent Contractors**
  - Unique skills and expertise.
  - Employers do not have to pay or withhold taxes (i.e., FICA, FUTA and Social Security).
  - Exempt from the FLSA's minimum wage and overtime protections.
  - Not covered by workers' compensation.
  - Generally do not receive other employment benefits (i.e., health insurance, pension, paid sick leave, etc.)
  - Independent contractors can't form a union.

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Staffing Firm Perspective Ensuring Proper Classification

- **Leased Employees**
  - Work with experienced staffing firms
  - Demand employees, but not specifics regarding benefits, pay, etc.
  - Never pay directly or provide benefits
  - Take employee complaints seriously, but demand that staffing firm HR/Legal departments handle
  - Allow staffing firms to handle hiring, terminations, training, feedback, etc.
  - Understand staffing firm's "employment" agreements
  - Train your managers
  - Conduct audits
  - Etc.

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Staffing Firm Perspective Ensuring Proper Classification

- **Independent Contractors**
  - Demand employees, not independent contractors
  - Strict contractual requirements, with penalties
  - Inquire about firms' use independent contractors
  - Create checklist of independent contractor characteristics
  - Minimize control
  - Avoid work patterns
  - No non-competes
  - Deliverable-based pay
  - Short duration
  - Appropriate contracts

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Is the Benefit Worth The Risk??

- Sometimes the use of leased employees or independent contractors makes good business sense……**BUT**
- The risks of misclassifying workers can prove disastrous.
  - FedEx $319 million
  - Microsoft $97 million
  - UPS $12.8 million

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What Are The Risks of Misclassification?

Potential legal exposure:

- Harassment, Discrimination and Retaliation Claims
- Wage and Hour Violations
- Family Medical Leave Act
- Employee Benefits
- Workers' Compensation Claims
- Tax Implications
- Criminal penalties

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Harassment, Discrimination, Retaliation

- Independent contractors are not covered by most anti-discrimination laws…unless they are improperly classified.
- Temporary and leased workers can create a "joint employer relationship."
  - For purposes of most employment laws, temporary employees will be considered to be employees of both the staffing agency and the employer.
  - A joint employer relationship creates a number of risks for the engaging company

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Harassment, Discrimination, Retaliation

- Temporary/leased workers are often dismissed quickly, without the same level of care and caution applied to permanent employees.
- But because there may be a joint employer relationship, employers must consider:
  - Harassment
  - Discrimination
  - Retaliation
  - Reasonable accommodation for individuals with disabilities
- Don't assume that the staffing agency is taking care of this for your company!

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Harassment

- Risk of harassment claims by independent contractors, employees of contractor companies, and leased workers
- Employers have a duty to protect all people in their workplace from harassment
- Risk increases significantly if joint employer status exists
- Ensure that all workers in workplace are advised of harassment policy so that *Ellerth/Faragher* defense is available

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Discrimination

- Discrimination claims arise from employment decisions: hiring, firing, promotion, etc.
- Risk of discrimination claims by contingent workers exists when joint employer status exists
- Ensure that engaging company employees are not making employment decisions for leased/contracted workers

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Retaliation

- Risk of retaliation or whistleblower claims by both independent contractors and leased workers
- Title VII only protects employees but other whistleblower protections are available
- Risk increases significantly if joint employer status exists because leased workers are then covered by Title VII (or similar state laws)

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Harassment, Discrimination, Retaliation – The Solution

- Treat your temps/leased workers the same as your regular employees with respect to federal/state laws:
  - Make clear to your temps/leased workers that they should report discrimination/harassment.
  - Conduct investigations into allegations of discrimination or harassment.
  - Offer reasonable accommodations for temps/leased workers with disabilities.
  - Treat all workers consistently.
- Seek indemnification agreement from contracting company

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Wage and Hour Compliance

Independent Contractors

- Independent contractors are not covered by the FLSA.
- Proper classification is critical to avoiding future wage claims.
- An agreement stating that the worker is being hired solely as an "independent contractor" or "freelancer" is not sufficient.
  - Recent example – FedEx cases

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Wage and Hour Compliance

- FLSA applies only to employees but
  - "Employee" is defined as any person whom the employer suffers or permits to work
  - Primary determination to determine worker's status for FLSA purposes is whether the company has the **right to control** how the work is performed by the worker

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Wage and Hour Compliance

- An FLSA or state wage/hour claim for overtime, missed meal periods, or other wage/hour violations will turn on the analysis of control
- In defending claims brought by independent contractors, the company must be able to demonstrate that it did not control the how/where/when of the contractor's work

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FMLA

FMLA applies only to "eligible employees":
- Employed for at least 12 months
- 1,250 hours of service

– **Scenario #1** - A temp performs services for 8 months and is then hired by the company as a regular employee. When does the employee become eligible for FMLA leave?

» Several courts have held that prior service as a temporary worker must be considered for eligibility purposes. Thus, the employee above could be eligible after 4 months of permanent employment.

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FMLA

FMLA applies to "covered employers":

- Must employ 50 or more employees

– **Scenario #2** - A company has had 45 regular employees and 10 temporary employees for the last year. Can the company claim that it is not covered by the FMLA because it only has 45 regular employees?

- **Maybe.** If there is no "joint employment" relationship between the company and the leased workers, the company only has 45 employees and is not covered by the FMLA. If, however, a joint employment relationship is found to exist, the employer may be liable for failing to provide leave as required by the FMLA.

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FMLA

Other Potential Issues:

– **Misclassified Contractors** - If a contractor is denied a request for leave that would otherwise be covered by the FMLA, and later proves that she was actually an "employee," the employer may have interfered with FMLA rights.

– **Approving FMLA Leave and Providing Notice** – Typically, this should be handled by the staffing agency. Make sure that your agreements provides that agency is responsible for approving FMLA leave and giving proper notices.

- If a temp requests FMLA leave directly from an employer, the request should always be communicated back to the staffing agency.

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Employee Benefits

- Many employee benefit plans exclude temporary workers.
  – Nothing unlawful about this, but be sure your company manual reflects specific exclusions for temporary and leased workers.
- If workers are misclassified, employers could be required to provide retroactive benefits to affected employees.
  – IRS and DOL have determined on numerous occasions that temporary or leased workers were, in fact, employees that should have been covered under the terms of employer's plans – i.e. Microsoft.

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Workers' Compensation

- If an company does not hold workers' compensation insurance on a worker who is later found to be an employee, the company will not have the protections of the workers' compensation system as the exclusive remedy.
- *Kinney v. Space Needle Corp*., 121 Wn.App. 242 (2004) Kinney was an employee of Pyro-Spectaculars, injured while installing Space Needle fireworks display. Court held that Kinney was an employee of SNC because of evidence that SNC retained control over the manner in which contractors completed work, especially in the area of safety.

But…

- *Kamla v. Space Needle Corp.*, 147 Wn.2d 117 (2002) Employee of Pyro-Spectaculars injured while working on Space Needle fireworks display. Court held that Kamla was not an employee of SNC because SNC did not exercise direction and control. There was evidence that SNC did not affirmatively take responsibility for safety or any other aspects of how the job was done.

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Criminal Penalties

- Many states have enacted laws that impose criminal penalties for improper worker classification.
  - Colorado, Maryland, New York and Massachusetts
- A proposed 2010 Virginia bill contemplated harsh criminal penalties:
  - Intentional misclassification (Class 2 misdemeanor, Class 1 for subsequent offenses)
  - Unintentional misclassification (Class 3 misdemeanor, Class 2 for subsequent offenses)
  - $5,000 penalty per violation

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Legal Tests

- The Federal government, state governments, and various government agencies each apply different tests to determine the proper classification
  - Economic realities test (FLSA)
  - Common law agency test (NLRA, ERISA)
  - IRS test
  - State laws (unemployment compensation insurance)
- The classification of an individual may be proper under one test and improper under others

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Control

- The most important factor is the right to control
  - IRS: "In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered."
- Does the company have the right to control how, when, and where the job is performed?

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Other Important Factors

- The individual's business
  - Does the individual hold himself/herself out to be a business and offer his/her services to the market?
- The parties' relationship
  - How do the individual and the company perceive their relationship and how does it appear to the public?
- Economic factors
  - How are they paid, how are expenses handled, and do they receive benefits?
- No one factor or set of factors is conclusive
  - Must examine all the factors and the entire relationship

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Potential Audit Triggers

- Independent contractor files a workers' compensation claim
- Independent contractor files for unemployment compensation benefits
- Whistleblower reports misclassification
- IRS, DOL, or a state unemployment agency selects companies in high risk industries
  - E.g. construction, food and beverage, and nail salons

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Potential Audit Trigger

- Routine audit
  - IRS employment tax
  - state unemployment tax
- Wage and hour claim
- Abundance of 1099s filed
- W2 wage payment and 1099 independent contractor payments to the same individual in the same tax year or consecutive years

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The Audit

- Audit notice/visit
- Preparing for the audit
- Conducting the audit
- Resolution
- Potential consequences of misclassification
- Lessons learned

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Audit Notice/Visit

- Audit letter
  - Period covered by audit
  - Scope of records to be reviewed
  - Specific entity being audited

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Audit Notice/Visit

- Agency will also request specific records
  - 1099s
  - Checks, cash payment records, and bank statements
  - Tax reports and income tax returns
  - Payroll records
  - Financial statements
  - List of the corporation's officers and related corporate entities

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Preparing For The Audit

- Form an internal team
  - Representatives from legal, HR, payroll, tax, and outside counsel
- Schedule conference call with the auditor
  - Determine the audit period
  - Limit scope
  - Also important to find out what triggered the audit

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Preparing For The Audit

- Separate EINs from SSNs
  - Focus audit preparation around 1099s
  - Red flag situations where a contractor received both a W2 and 1099 in the same year or consecutive years
- Consider setting aside reserves and issuing a litigation hold

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Preparing For The Audit

- Conduct interviews with department heads and managers to obtain background information
  - Ascertain contractor's role and responsibilities or a description of the services he/she rendered
  - Determine if the contractor had other clients
  - Obtain as much detail about working relationship as possible
- Group all the individuals involved in the audit by categories if possible
- Determine if contractor's services are also performed by employees and focus on the differences

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Preparing For The Audit

- Review contracts, invoices, and any other documents that support independent contractor status
  - Websites
  - Advertisements
  - List of clients
- Review company records to determine if a prior audit has been conducted
  - What was the outcome?
  - Are there similar issues this time?
- Consider whether there are any fraud or penalty issues

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Conducting The Audit

- Auditor may want to schedule an onsite visit
- Suggest meetings be held in a neutral location (e.g. outside counsel's office)
- Schedule subsequent conference calls in an attempt to narrow the scope of the investigation
- If possible, send documents to the auditor after the request has been made

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Conducting The Audit

- Auditor will typically ask for all 1099s for a three year period
  - If this is a large amount of data, the audit may focus on a random number of 1099s from each year or a spot check
  - Audit can also include review of all 1099s
- Submit the most defensible cases to the auditor first

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Conducting The Audit

- Provide an honest assessment where misclassifications are obvious or it is clear the company will not be able to defend them
- Cooperate with the auditor to the fullest extent
- Schedule a meeting with the auditor to review the borderline and difficult cases

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Resolution

- Negotiate settlement amount
  - When submitting settlement check to agency, reserve all rights and indicate you are not admitting liability for misclassifications
- Negotiate penalties and fines
- Make voluntary changes
  - Agree to reclassify some workers
  - Identify potential third party vendors

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Potential Consequences Of Misclassification

- Back pay & liquidated damages
- Back taxes, interest, & penalties
- Social Security & FICA
- Disqualification of company benefit plans
- Liability for overtime, meal periods, PTO, leaves, and rest breaks

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Potential Consequences of Misclassification

- Contractor claims 401(k), severance, health/welfare coverage, employee stock purchase plans
- Criminal and civil penalties and sanctions
- Additional contributions to unemployment compensation and workers' compensation funds

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Lessons Learned

- Work with HR to develop independent contractor guidelines
  - Consider written policy changes as applicable
- Update hiring and contractor engagement procedures so contractors are properly classified moving forward
- Conduct your own internal audit and investigate current classification practices
  - Consider attorney-client privilege issues
- Have a detailed description of the services performed by the contractor for your records

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Lessons Learned

- Research contractors on your own to make sure they have other clients and hold themselves out to the public by advertising or having a website
- Require all contractors to obtain a federal tax ID number

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Lessons Learned

- Always have a written contract for independent contractors
  - Important provisions include specifying that contractors are free from control, they have insurance, and they can hire their own employees
  - Be wary of intellectual property issues
  - Work with Accounts Payable Department to ensure that contractors are only paid if there is a contract in place

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Lessons Learned

- Avoid having contractors use company equipment and offices
- Refrain from hiring independent contractors to perform the same type of service as an employee or former employee of the company
- Make sure contractors submit their own invoices

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Lessons Learned

- Don't rehire a former employee as an independent contractor to perform the same services
- Consider using a third party vendor to hire contractors
  - Be mindful of joint employer issues
- Form an HR/legal swat team to deal with these issues before they arise

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CHAPTER 24

CONTINGENT WORKERS: INDEPENDENT CONTRACTORS & LEASED EMPLOYEES

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CHAPTER 24

CONTINGENT WORKERS: INDEPENDENT CONTRACTORS & LEASED EMPLOYEES

§ 24.1

I. RECENT TRENDS & DEVELOPMENTS

Determining independent contractor status for various federal laws remains a complicated area for review. The case law continues to be very fact-sensitive. While the use of Professional Employee Organizations (PEOs) has become more common, both PEOs and their clients need to be very careful, both in the operation and formalities of structuring such relationships. With PEOs, the prospects of joint employer relationships with respect to some laws is strong, as evidenced by recent cases.

The Internal Revenue Service (IRS) has been particularly aggressive in prosecuting PEOs that have not met their obligations to remit tax payments. While there is no federal legislation regulating PEOs, many states do have restrictions in place. There has also been some discussion of enacting federal legislation to regulate PEOs. In addition, personal liability of "responsible persons" for tax remittance problems may be a real risk for individuals with control over an organization's finances.

§ 24.2

II. OVERVIEW OF USING CONTINGENT WORKERS

§ 24.2.1

A. THE CONTINGENT WORKFORCE

As business competition continues to rage at a breakneck pace, companies operate under constant pressure to explore novel ways for engaging workers more efficiently to accomplish critical objectives such as meeting urgent client demands, expanding sales or repairing a weakened administrative infrastructure. Such workers are referred to in this chapter as

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"contingent workers," so long as they are not engaged as full-time employees by the company for whom they perform services.

The focus of this chapter is limited to one aspect of contingent workers, namely, the legal implications of that status.

From a strictly legal perspective, a company's obligations to a worker depend principally on whether the worker is an employee or an independent contractor with respect to the company. There are no other options. While some statutes create a "fictional" status for limited purposes, those provisions still divide workers in two categories: employees and independent contractors.

A company can engage a worker in four ways:

- directly as its own employee;
- directly as an independent contractor;
- through a third party as its employee; or
- through a third party as an independent contractor.

The first two options are discussed below under the heading "Independent Contractors," and the last two options are discussed below under the heading "Leased Employees and PEOs."

§ 24.2.2

B. INDEPENDENT CONTRACTORS

From a company's perspective, the ability to engage independent contractors allows the company to react nimbly to marketplace demands by quickly expanding its service capabilities in specific areas where demand is hot and precipitously contracting its service capabilities in reaction to cooling demand. Likewise, when a particular problem demands a rapid solution, the availability of independent contractors allows a company to engage highly-trained and specialized professionals to remedy the problem quickly.

From an independent contractor's perspective, the status provides an opportunity for one to focus his or her entire efforts on the individual's area of expertise, and to maintain control over when, where, and for whom he or she will perform services. It also affords the individual an opportunity to grow professionally at a rapid pace by obtaining broad exposure to different clients with unique needs.

While independent contractor status clearly benefits companies and individuals, it draws fierce opposition from governmental regulatory agencies. Traditionally, tax collection agencies have been the most hostile toward independent contractors, however, other agencies have recently joined the attack. Among them are the Equal Employment Opportunity Commission (EEOC), the National Labor Relations Board (NLRB), and state agencies charged with administering the state's unemployment program.

Another growing source of attack comes from the independent contractors themselves. As evidenced by the widely reported class action lawsuit filed against Microsoft Corporation, some independent contractors contest their status in order to gain access to employee benefit programs maintained by the company for which they perform services.

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As the foregoing reveals, the independent contractor option can be as treacherous as it is rewarding. Fortunately, the law is sufficiently developed that companies can engage independent contractors in a manner that mitigates or, in some cases, minimizes the risk of attack by government agencies or by the independent contractors. This section of the Chapter focuses on how a company can engage independent contractors in a manner that limits the company's liability under applicable tax, labor, and employment laws.

§ 24.2.2(a)

Independent Contractor Status for Federal Tax Purposes

Critics of independent contractor status historically have asserted that the federal government loses tax revenues as a consequence of workers being classified as independent contractors rather than employees. That assertion was debunked, however, by a U.S. Treasury Department report.

In a report to the Congress, the Treasury Department concluded that "current law does not consistently favor status as either an employee or an independent contractor."[1] The Treasury Report also pointed out that:

> Prior to 1982, compensation earned by independent contractors was taxed at substantially lower rates under the Social Security and Medicare tax provisions of the Internal Revenue Code than wage income, apparently creating significant incentive for misclassification. Subsequent legislation has essentially eliminated this important difference.

Consequently, any tax preferences in favor of independent contractor status over employee status have been removed. The Treasury Report ultimately concluded that the independent contractor classification could reduce federal tax revenues *only* if the independent contractors underreported their taxable income, either by understating their income or overstating their deductions. Nonetheless, a more recent study suggests that independent contractors do just that:

> There is revenue loss associated with lower compliance rates of independent contractors and service recipients compared to the compliance rates of employees and their employers. This revenue loss, however, is not necessarily the result of misclassification of a worker's status, but is largely due to differences in the rules, such as reporting and withholding requirements, that apply as a result of worker classification, regardless of whether that classification was legally correct.[2]

Companies and agencies found by the IRS to have misclassified workers as independent contractors may be subject to employment tax liabilities, including 100% of the combined worker-employer contribution under the Federal Insurance Contributions Act (FICA), comprised of both Social Security and Medicare taxes (up to 15.3%), federal income tax not withheld, and federal unemployment insurance tax (FUTA), as well as penalties and interest. If assessed, the engaging company or agency generally cannot recover these amounts from

[1] DEPARTMENT OF THE TREASURY, TAXATION OF TECHNICAL PERSONNEL: SECTION 1706 OF THE TAX REFORM ACT OF 1986: A REPORT TO CONGRESS 12 (1991).

[2] JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATING TO WORKER CLASSIFICATION FOR FEDERAL TAX PURPOSES (JCX-26-07), at 10 (May 7, 2007), *available at* www.house.gov/jct.

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the independent contractor. However, if the engaging entity can prove that the worker paid the taxes, the amount of back taxes owed may be reduced. In addition, Internal Revenue Code (Code) section 3509 allows for a substantial reduction to the amount of back taxes owed for *unintentional* violations of income tax withholding and FICA tax contribution requirements.

However, in November 2007, the IRS enacted the Questionable Employment Tax Practices (QETP) initiative "to identify employment tax schemes and illegal practices and increase voluntary compliance with employment tax rules and regulations."[3] Departments in California, Michigan, New Jersey, New York, and North Carolina worked together to develop this initiative. In total, 29 states[4] have signed information exchange agreements between the IRS and state workforce agencies that will help monitor employment taxes and increase compliance at both the state and federal levels. This new program will likely mean stricter enforcement of employment tax laws and thus, it is more important than ever to make sure that workers are properly classified and the appropriate taxes are remitted.

In addition, beginning in 2008, the IRS released Form 8919. This form allows workers that were treated as independent contractors to report unreported wages for FICA purposes. The worker is also required to file or have filed an SS-8 Form requesting a determination from the IRS regarding his/her status as either an employee or independent contractor. Since then, the number of requests for determinations of worker status has nearly doubled. This is likely to significantly increase scrutiny of worker status and employer audits.

Additionally, if the Taxpayer Responsibility, Accountability and Consistency Act of 2009 (H.R. 3408) is passed into law, independent contractors will have greater responsibilities. The Act would amend the Internal Revenue Code of 1986 to set forth criteria and rules "relating to the treatment of individuals as independent contractors or employees."

§ 24.2.2(a)(i)

Determining Worker Status — An Overview

For federal employment taxes purposes, the IRS is responsible for determining whether a worker qualifies as an employee or independent contractor. Federal employment taxes are imposed only on wages paid to employees.

A worker's status must be determined separately for each of the three different federal employment taxes, namely, FICA taxes, FUTA taxes, and federal income tax withholding. "Employee" status is defined slightly differently for each tax.

§ 24.2.2(a)(ii)

Workers Subject to FICA Taxes

FICA taxes are imposed on wages paid to an employee. The employer also pays FICA taxes. In addition, the employer is responsible for withholding and remitting the entire amount of FICA taxes to the government.

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[3] Information on the Questionable Employment Tax Practices Memorandum of Understanding (Nov. 2007), *available at* http://www.irs.gov/newsroom/article/0,,id=175455,00.html.

[4] The states that signed the exchange agreement are Arizona, Arkansas, California, Colorado, Connecticut, Hawaii, Idaho, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, and Wisconsin. *Id.*

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Compensation paid to an independent contractor is exempt from FICA taxes. Instead, that compensation is subject to the Self-Employment Contributions Act (SECA) tax, which is imposed fully on the worker. The business does not pay (or withhold) any portion of SECA taxes.

For purposes of FICA taxes, the term *employee* includes:[5]

- an officer of a corporation;
- an individual determined to be an employee under the common law rules; and
- a statutory employee.

Statutory employees for FICA tax purposes include:[6]

- An agent-driver or commission-driver engaged in distributing for another:
  - meat products;
  - vegetable products;
  - fruit products;
  - bakery products;
  - beverages other than milk; or
  - laundry or dry-cleaning services.
- A full-time life insurance salesman.
- A home worker who performs work according to specifications provided by the service recipient on material or goods provided by the service recipient that must be returned when the work is completed.
- A traveling or city salesman who is engaged on a full-time basis in the solicitation of sales to wholesalers, retailers, contractors, or operators of hotels, restaurants, and similar establishments for:
  - merchandise for resale, or
  - supplies for use in the respective business operations.
- Certain individuals engaged to perform services for a state or local government agency.

The first four categories of statutory employees are subject to additional requirements and qualifications. These categories also require that a worker's contract provide that the worker will personally perform substantially all of the services.[7] In addition, the categories require that:

- the individual *not* have a substantial investment in the facilities used in connection with the performance of services; and

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[5] I.R.C. § 3121(d)(1)-(3) (2008).

[6] *Id.* § 3121(d)(3)(A)-(D).

[7] *Id.* § 3121.

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- the services be performed as part of a continuing relationship with the company, and not be in the nature of a single transaction.[8]

The statutory employee provisions classify an individual — who otherwise may qualify as an independent contractor under the common law rules — to be an employee for purposes of FICA taxes.

In addition to the foregoing rules, Code section 3121 contains a long list of exceptions that have the effect of exempting an individual from FICA taxes.

§ 24.2.2(a)(iii)

FICA Tax Litigation

A company may be exposed to disputes with both workers and regulatory agencies because FICA taxes have both an employer component and an employee component. In *Ford v. Troyer*,[9] a Louisiana district court, while recognizing a split among the federal courts on the issue, held that a worker who has been misclassified as an independent contractor has standing to sue the company and seek a court to compel the company to comply with FICA and FUTA. However, the court determined that the plaintiff did not have a similar right with respect to the federal income taxes that should have been withheld.

The court concluded while the Code did not expressly authorize an individual to sue an employer for failure to comply with FICA and FUTA tax obligations, there was an *implied* right of action. The court adopted the analysis in *Sanchez v. Overmyer*,[10] which found a private right of action under FICA. The court reasoned that a private right of action to compel compliance with duties imposed by FICA and FUTA existed because those taxes benefited the worker. A private right of action did not exist for federal income tax, because income tax benefited only the federal government as a revenue collection measure.[11] However, more recently, two courts have held that workers could not sue businesses for failure to pay FICA taxes because FICA was a revenue-raising statute for the federal government.[12]

§ 24.2.2(a)(iv)

Workers Subject to FUTA Taxes

FUTA taxes are imposed on an employer with respect to the wages paid an employee. An employee does not bear any portion of FUTA taxes. Compensation paid to an independent contractor is *exempt* from FUTA taxes.

The term "employee" has a narrower definition under FUTA than FICA. Code section 3306(i) defines *employee* for FUTA identical to FICA, with three exceptions: full-time life insurance salesmen, home workers, and state or local government workers are *not* employees for FUTA tax purposes.

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[8] *Id.*

[9] 25 F. Supp. 2d 723 (E.D. La. 1998).

[10] 845 F. Supp. 1178 (N.D. Ohio 1993).

[11] See also *Ahmed v. United States*, 147 F.3d 791 (8th Cir. 1998), where the court found that an employee who authorized his employer to file an administrative claim seeking a refund of the employee share of FICA taxes did not waive his right to pursue the refund in court on his own behalf.

[12] *Paukstis v. Kenwood Gold & Country Club, Inc.*, 241 F. Supp. 2d 551 (D. Md. 2003); *Berger v. AXA Network, L.L.C.*, 2003 U.S. Dist. LEXIS 11555 (N.D. Ill. July 7, 2003).

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In addition, as is the case for FICA taxes, Code section 3306 contains a long list of exceptions that exempt certain workers from FUTA taxes.

§ 24.2.2(a)(v)

Workers Subject to Federal Income Tax Withholding

An employer is required to withhold (and remit to the government) an appropriate amount of federal income taxes from employee's wages. No withholding is required with respect to compensation paid an independent contractor.

The term *employee* is defined most narrowly for purposes of federal income tax withholding. According to Code section 3401(c), the term includes only the following types of workers:

- an officer, employee, or elected official of the United States, a State, or a political subdivision thereof or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing;
- an officer of a corporation; and
- an employee under the common law test.

There are no "*statutory*" employees for federal income tax withholding purposes. Also, an individual could be an employee for FICA taxes, but not FUTA taxes. Likewise, an individual could be subject to FICA taxes and FUTA taxes, but not federal income tax withholding. In determining the status of a worker, each of the three separate taxes must be analyzed separately.

§ 24.2.2(a)(vi)

IRS Classification Settlement Program

While any company under IRS investigation for treating workers as independent contractors should vigorously defend against the claim, in certain extraordinary circumstances, the treatment simply cannot be defended. A company facing that predicament should consider a settlement program instituted in 1996 entitled the Classification Settlement Program (CSP).[13] This program allows IRS examiners to settle certain worker-classification disputes under favorable financial terms in exchange for the company agreeing to prospectively reclassify the workers at issue, and all others holding substantially similar positions, as employees.

Although the CSP initially was established on a trial basis for a limited period of time, the IRS announced an indefinite extension of the CSP "until further notice."[14] The IRS indicated that the program, which is entirely voluntarily, has generated positive feedback from taxpayers.

§ 24.2.2(b)

The IRS's 20 Common Law Factors

While the term "employee" is defined slightly differently for each of the federal employment taxes discussed above, the common law test applies for *all* federal employment taxes. A

[13] Classification Settlement Program, *available at* http://www.irs.gov/irm/part4/irm_04-023-006.html .

[14] I.R.S. Notice 98-21, 1998-15 I.R.B. 14.

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worker who qualifies as an employee under the common law test would be treated as such for all federal employment taxes, unless an exception applies.

According to the IRS Manual, under the common law test, a worker is an *employee* if:

> the person for whom he works has the right to direct and control him in the way he works both as to the final results and as to the details of when, where and how the work is to be done. The employer need not actually exercise control. It is sufficient that he has the right to do so.[15]

In 1987, the IRS issued Revenue Ruling 87-41,[16] and identified 20 factors to help determine whether the engaging entity retains the requisite right to control the means and methods of worker performance to qualify such worker as an employee.

The 20 common law factors weigh in favor of *independent contractor* status under the following circumstances:[17]

1. *No instructions*. An independent contractor does not receive instructions from the engaging entity as to how to accomplish a job.
2. *No training*. An independent contractor does not receive training from the engaging entity.
3. *No integration*. The engaging entity's operations or ability to be successful does not depend on the service of independent contractors. By contrast, the factor weighs in favor of employee status if the workers constitute a critical and essential part of the taxpayer's business.
4. *Services do not have to be rendered personally*. Because independent contractors are in business for themselves and are contracted with to provide a certain result, they have the right to hire others to assist them.
5. *Control their own assistants*. Independent contractors retain the right to control the work activities of their assistants.
6. *Not a continuing relationship*. Unlike employees, independent contractors generally do not have a continuing working relationship with the engaging company, although the relationship may be frequent, by means of multiple engagements.

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[15] I.R.S. Man. § 5(10)43.

[16] Rev. Rul. 87-41, 1987-1 C.B. 296.

[17] THE INTERNAL REVENUE SERVICE MANUAL, *4600 Employment Tax Procedures*, Exhibit 46401, provides that workers are generally employees if they: (1) must comply with employer's instructions about the work; (2) receive training from or at the direction of the employer; (3) provide services that are integrated into the business; (4) provide services that must be rendered personally; (5) hire, supervise, and pay assistants for the employer; (6) have a continuing working relationship with the employer; (7) must follow set hours of work; (8) work full-time for an employer; (9) do their work on the employer's premises; (10) must do their work in a sequence set by the employer; (11) must submit regular reports to the employer; (12) receive payments of regular amounts at set intervals; (13) receive payments for business and/or traveling expenses; (14) rely on the employer to furnish tools and materials; (15) lack a major investment in facilities used to perform the service; (16) cannot make a profit or suffer a loss from their services; (17) work for one employer at a time; (18) do not offer their services to the general public; (19) can be fired at any time by the employer; and (20) may quit work at any time without incurring liability.

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7. *Work hours are set by the independent contractor*. An independent contractor has control over the hours worked for accomplishing the result.[18]

8. *Time to pursue other work*. An independent contractor is free to work when and for whom the individual chooses. A requirement to work full-time indicates control by the engaging entity.

9. *Job location*. Unless the services cannot be performed elsewhere, an independent contractor has the right to choose where the work will be done.

10. *No requirements on the order or sequence of work.* Independent contractors have control over how a result is accomplished and, therefore, determine the order and sequence in which their work will be performed.

11. *No required reports.* Independent contractors are accountable for accomplishing the objective only; interim or progress reports are not required.

12. *Payment for the result.* Independent contractors are paid by the job and are not compensated based on the time spent performing the work.

13. *Business expenses.* Independent contractors are responsible for their incidental expenses.

14. *Own tools.* As business owners, independent contractors provide their own equipment and tools to do the job.

15. *Significant investment.* An independent contractor's investment in his or her trade is *bona fide*, essential, and adequate.

16. *Possible profit or loss.* Independent contractors bear the risk of realizing a profit or incurring a loss.

17. *Working for multiple firms.* Independent contractors are free to work for more than one firm at a time.

18. *Services available to the general public.* Independent contractors make their services available to the general public.

19. *Limited right to discharge.* An independent contractor is not terminable at will, but may be terminated only for failure to comply with the terms of the contract.

20. *Liability for noncompletion.* Independent contractors are responsible for the satisfactory completion of a job and are liable for failing to complete the job in accordance with the contract.

To determine whether a worker qualifies as an independent contractor, the relationship between the worker and a business is analyzed with the aid of the 20 common law factors. No one factor is decisive; however, the degree of importance of each depends on the occupation and factual context in which services are being performed.[19]

[18] However, the Seventh Circuit Court of Appeals has repeatedly held that "[m]erely setting a work schedule is not sufficient to support a finding that a given person is an employee rather than an independent contractor." *Suskovich v. Anthem Health Plans of Va., Inc.*, 553 F.3d 559, 566 (7th Cir. 2009) (citing *Ost v. Western Suburban Travelers Limousine Co.*, 88 F.3d 435, 438 (7th Cir. 1996)).

[19] *American Consulting Corp. v. United States*, 454 F.2d 473, 477 (3d Cir. 1971); Rev. Rul. 87-41, 1987-1 C.B.

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§ 24.2.2(b)(i)

IRS Training Guidelines

The IRS uses training guidelines (Training Guidelines)[20] to educate its agents on the difference between employees and independent contractors. The Training Guidelines cover all aspects of worker classification for federal tax purposes, including the common law test and the separate tests for FICA, FUTA, and federal income tax withholding. Major statutory independent contractor provisions also are covered, including section 530 of the Revenue Act of 1978. Overall, the Training Guidelines present a balanced approach for classifying workers as either employees or independent contractors.

The Training Guidelines distill the common law rules into three categories, each focusing on a different aspect of a service relationship:

1. behavioral control;
2. financial control; and
3. the relationship of the parties.

Under the *behavioral control* category, the Training Guidelines identify factors for evaluating an entity's right to control the manner in which a worker performs services, including whether the worker is provided with instructions and training concerning the means or methods of performance.

Under the *financial control* category, the Training Guidelines identify factors for evaluating an entity's right to control the financial aspects of a worker's activities. The factors include:

- whether the worker has made a significant investment in his or her business (although recognizing that certain types of work do not require a significant investment);
- whether the worker is responsible for expenses incurred in the performance of services;
- whether the worker makes his or her services available to the relevant market;
- the method of payment of the worker's fees; and
- whether the worker has the opportunity for a profit or loss.

Under the final category, *relationship of the parties*, the Training Guidelines identify factors for evaluating how the parties perceive their relationship. Those factors include:

- the expressed intent of the parties (possibly as revealed by the written contract or by whether the compensation paid the worker is reported on a Form 1099 or a Form W-2);
- whether the worker is provided with employee benefits;
- whether the worker can be discharged, or the contract terminated, without notice; and
- whether the services performed for the business are a key aspect of the regular business activity of the company.

[20] The Training Guidelines can be found at http://www.irs.gov/taxpros/article/0,,id=98941,00.html.

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The Training Guidelines deemphasize the importance of the remaining factors of the common law test. They also contain abundant specific examples of how the IRS has modified its application of the common law test to better reflect contemporary business practices. For example, the Training Guidelines now acknowledge that when a business engages a worker to perform services for the client company, any instructions provided by the client company are not imputed to the business, unless the business adopts the client company's instructions as its own. In addition, the Training Guidelines now interpret a requirement that a worker wear a uniform or put a business logo on a vehicle as a nonfactor, so long as the uniform or logo is required for security or safety purposes. The Training Guidelines also make clear that the characterization of a worker under state law is irrelevant with respect to characterization for federal tax purposes.

Factors deemed as less determinative include whether a worker is engaged on a part-time or full-time basis, the hours that must be worked, and the location where the services must be performed.

§ 24.2.2(b)(ii)

IRS Industry Guidelines

The IRS has supplemented its administrative guidance by issuing industry guidelines[21] that offer bright lines for engaging workers as independent contractors within specified industries. The guidelines are the result of a collaborative effort between the IRS and representatives of the industry at issue.

§ 24.2.2(b)(iii)

Court Decisions & IRS Rulings

Although court decisions and IRS rulings can be helpful in determining a worker's status, companies should be extra cautious when relying on such precedents, which are generally highly fact specific. For example, golf professionals have been ruled to be employees in some cases[22] and independent contractors in others.[23] There are countless examples of this phenomenon for other types of workers as well.

Nonetheless, when structuring an independent contractor engagement, IRS rulings and court decisions that analyze workers in a similar industry under similar circumstances can offer helpful insights into how the engagement should be structured. The following represents a sample of some of the significant rulings and decisions that have applied the common law test.

Owner-Operator Truck Drivers

In Technical Advice Memorandum (TAM) 9814001 (Apr. 3, 1998), the IRS concluded that owner-operator truck drivers engaged in delivering packages from wholesale distributors to retail outlets qualified as independent contractors for federal tax purposes. An employee of the taxpayer generally would pick up a package and deliver it to taxpayer's distribution center during the night. All deliveries from the warehouse to customers were handled by

[21] The industry guidelines can be found at http://www.irs.gov/businesses/small/industries/index.html.

[22] Rev. Rul. 68-626, 1968-2 C.B. 466.

[23] Rev. Rul. 68-625, 1968-2 C.B. 465.

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owner-operators. The IRS concluded that the owner-operators qualified as independent contractors for federal tax purposes based on the following findings:

- Owner-operators were engaged under a written agreement.
- Both parties believed they were creating an independent contractor relationship.
- Owner-operators were paid at a specified rate rather than by the hour or by mileage.
- Owner-operators performed their services using their own vehicles and equipment and bore all costs associated with performing the services.
- Although drivers were told where to deliver merchandise, they were not instructed as to when or how to effect the deliveries.

In addition to providing clear guidelines for engaging an owner-operator as an independent contractor, TAM 9814001 suggests that a bonus payment as a part of the compensation agreement does not undermine the independent contractor classification.

In *Day v. Commissioner*,[24] the Tax Court utilized a seven-factor test to evaluate a long haul drivers' status when the trucking company, rather than the drivers, virtually assumed all financial risk. The seven-factors were: (1) how integral was the trucker's services to the business; (2) the degree of permanency of the relationship; (3) special skills needed; (4) ability of driver to profit through management; (5) extent of costs incurred without reimbursement by the driver; (6) the degree of the driver's investment in a business; and (7) the trucking company's right of control as evidenced by the requirements to make progress calls daily, control over truck repairs, the type of loads hauled, and the charges imposed on customers. In a California state court case, the court established that workers were contractors where they chose their own schedules, worked as much as or as little as they wished, and could choose whether or not to haul any particular load. Also, they were free to substitute drivers when ill or on vacation.[25]

Insurance Agents

Insurance agents have been consistently held to qualify as independent contractors for federal employment tax purposes.[26]

In December 1996, the IRS Chief Counsel's Office sent a notice to IRS Districts advising them not to challenge the independent contractor status of insurance agents. The IRS was reacting to the string of losses it had suffered in U.S. Tax Court litigation over the issue. In addition, the National Labor Relations Board has found agents to be contractors not entitled to union representation.

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[24] 2000 Tax Ct. Memo (CCH) 375 (2000).

[25] *Albillo v. Intermodal Container Serv., Inc.*, 114 Cal. App. 4th 190 (2003); *see also FedEx Home Delivery, Inc. v. NLRB*, 563 F.3d 492, 504 (D.C. Cir. 2009) (holding that the company did not misclassify drivers as independent contractors where the drivers had authority to operate multiple routes, hire their own employees, sell routes without company approval, "as well as the parties' intent expressed in the contract," as evidence that the plaintiffs were independent business owners).

[26] *See, e.g., Butts v. Commissioner*, 49 F.3d 713 (11th Cir. 1995); *Mosteirin v. Commissioner*, 70 Tax Ct. Memo (CCH) 305 (1995); *Smithwick v. Commissioner*, 66 Tax Ct. Memo (CCH) 1545 (1993). *But see Hopkins v. Cornerstone Am.*, 545 F.3d 338 (5th Cir. 2008) (finding that management-level sales leaders for an insurance company are employees under the FLSA).

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Engaging Former Employees as Independent Contractors

Private Letter Ruling 93-45002 (1993) illustrates that engaging former employees as independent contractor consultants can be risky, but under certain circumstances can be accomplished. In the ruling, the IRS made different determinations concerning former employees who were engaged as independent contractors. The individuals each had consulting contracts that provided for: (1) a stated number of hours of consulting services (part-time); (2) compensation at an annual rate, to be paid whether or not consulting services were required; (3) expiration of the contract at a fixed time; (4) no specific hours (time of day); (5) no right to recall a worker from vacation or illness; (6) freedom to contract with other companies; and (7) maintenance of separate office space.

The IRS concluded that four of the executives, including a former chief executive officer, qualified as independent contractors partly because they received a fraction of their prior salary to provide part-time advisory services on an irregular basis. In providing consulting services, each of the four former executives was free to follow his or her own established routines and schedules and none was under the supervision. On the other hand, the IRS held that two of the former executives remained employees. These two executives worked up to 75% of the time that they had worked prior to retirement and were assigned to highly specific duties at fairly regular hours.[27]

Engaging an incorporated former employee may not avoid IRS scrutiny. Two former school superintendents set up a corporation and a limited liability corporation through which they provided the same services as they had as employees. In Chief Counsel Advisory 200147006 (Nov. 23, 2001), the IRS determined that they were also employees for tax purposes under a common law analysis, in part because the roles they continued to fill were "employee" positions.

The pitfall of mass conversion of employees to contractor status is well illustrated in a Tax Court case. In *Ewens & Miller, Inc. v. Commissioner*,[28] the entire bakery workforce was converted unilaterally to independent contractors without any substantive change in the business relationship, based on counsel's questionable advice.

Dual Status Workers

The IRS and courts traditionally have recognized that a worker can be engaged by one entity as both an employee and as an independent contractor. In those circumstances, at the end of a calendar year, the entity would issue the worker both a Form W-2 (to report employee wages) and a Form 1099 (to report compensation of at least $600 earned as an independent contractor).

In Private Letter Ruling 9914044 (Apr. 9, 1999), the IRS clarified that a worker can qualify as a dual-status worker, provided that the worker is engaged in a different function for each status. Alternatively, a worker can qualify for a dual status if engaged in a different aspect of a single function, provided that each aspect is independent of the other and the method of payment for each is different. In the ruling, a worker was engaged to prepare transcripts as an independent contractor, and paid on a job-by-job basis. Separately, the individual was

[27] For additional IRS rulings on this issue, *see* I.R.S. Priv. Ltr. Rul. 00-06033 (Feb. 11, 2000) (ruling that a technical service specialist engaged to perform function formerly performed was an employee); I.R.S. Priv. Ltr. Rul. 91-38017 (Sept. 20, 1991) (ruling that a packaging operator engaged to perform similar services was an employee).

[28] 117 T.C. 263 (2001).

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engaged by the same entity to attend and record proceedings, and paid a fixed salary. The IRS approved the entity's treatment of the worker in those dual capacities.

In Private Letter Ruling 200033014 (Aug. 18, 2000), the IRS found an otherwise statutory independent contractor to be a "dual status" worker. A realtor acted as both a real estate agent as well as the company's office manager. In order for him to be treated as an independent contractor, "substantially all remuneration"[29] (90% or more) he received must have been for services performed as a real estate agent. In this case, the realtor also acted as the office manager and was paid accordingly. The IRS ruled that as to income received as realtor, the individual was self-employed. As to the income received as office manager, it constituted employment and was taxable wages.

Freelance Writers

An important 1996 IRS Private Letter Ruling demonstrates how a company can engage a freelance writer as an independent contractor. In Private Letter Ruling 96-39060 (Sept. 27, 1996), the IRS confirmed that a writer engaged by a firm to assist in writing a book for one of the firm's clients qualified as an independent contractor for federal tax purposes.

The writer was engaged under a written contract to write several chapters and to review and revise other chapters of the book. The contract specified deadlines for completion of each chapter, but otherwise refrained from imposing any conditions on the procedures or formats to be followed. Drafts were submitted to the firm for review and comment. The writer was compensated by a specified amount for completing each chapter and was reimbursed for out-of-pocket expenses. No services were performed on the firm's premises, except when the writer would meet with firm representatives to discuss the book.[30]

Construction Workers

A federal court has held that although a construction worker performed essentially the same job as an employee, he may be classified as an independent contractor if four factors are satisfied:

1. he signed an independent contractor agreement;
2. he could work for others during the same time period;
3. he submitted invoices weekly; and
4. he was not paid overtime.[31]

§ 24.2.3

C. STATUTORY INDEPENDENT CONTRACTORS FOR FEDERAL TAX PURPOSES

Three safe-harbor provisions allow certain workers to qualify as independent contractors by law. The most widely used safe harbor is contained in section 530 of the Revenue Act of

[29] Prop. Treas. Reg. § 31.3508-1(d)(1).

[30] *But see* I.R.S. Tech. Adv. Mem. 96-39-002 (Sept. 27, 1996) (ruling that a graphic designer was an employee).

[31] *Richard Mulzet v. R.L. Reppert*, *Inc*., 54 Fed. App'x 359 (3d Cir. 2002).

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1978. Unlike most tax provisions, section 530 has never been incorporated into the Internal Revenue Code ("Code").

Additional statutory safe harbors are contained in the Code. Code section 3508 provides statutory independent contractor status for workers that qualify as either direct sellers (which include individuals who sell products for such companies as Avon and Amway) and realtors. The Small Business Job Protection Act ("1996 Act") modified Code section 3508 by including newspaper delivery persons as an additional category of statutory independent contractors.

Under Code section 3506, individuals who provide homecare services through a referral agency that meets certain criteria are independent contractors with respect to the agency (but not necessarily with respect to the client).

Each statutory safe harbor is discussed separately below.

§ 24.2.3(a)

Section 530 of the Revenue Act of 1978

Without question, the most important of the safe-harbor provisions is section 530. While the other safe-harbor provisions apply only to workers within a specific industry, section 530 applies to all industries (with limited exceptions discussed below). It provides an eligible business with relief from liability resulting from the IRS reclassifying covered workers as employees for purposes of federal employment taxes.[32]

Section 530 grew out of vociferous taxpayer complaints about overzealous IRS efforts seeking to reclassify workers to employee status. Prior to the 1970s, IRS audits only occasionally included an examination of worker status issues; businesses generally relied on their own judgment or industry practice in determining a worker's status. Beginning in the early 1970s, however, the IRS significantly increased its efforts to reclassify workers as employees. By the late 1970s, Congress reacted by enacting section 530. The provision was intended to curb the IRS's challenges to independent contractor classifications.

§ 24.2.3(a)(i)

Requirements of Section 530 Protection — An Overview

According to section 530, a company may continue to classify its workers as independent contractors if it: (1) has consistently treated the workers (and similarly situated workers) as independent contractors since 1978; (2) has complied with the Form 1099 reporting requirements for the taxable year at issue; and (3) had a "reasonable basis"[33] for treating the workers as independent contractors.

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[32] Although H.R. Res. 1802 (introduced in 2003) sought to end the audit safe harbor of section 530, nothing was passed into law. Businesses engaging the services of independent contractors, however, should track any changes in the safe-harbor provision, as the consequences could be severe.

[33] *See, e.g.*, *Peno Trucking, Inc. v. Commissioner,* 296 Fed. App'x 449 (6th Cir. 2008) (holding that company could rely upon state administrative proceedings that applied common law rules for purposes of safe harbor); *Dutch Square Med. Ctr. L.P. v. United States*, 1994 U.S. Dist. LEXIS 13336, 94-2 U.S. Tax Cas. (CCH) ¶ 50,490 (1994) (finding that the firm had no "reasonable basis" under section 530 for treating physicians as independent contractors); *In re Bentley*, 1994 Bankr. LEXIS 261, 94-1 U.S. Tax Cas. (CCH) ¶ 50,140 (E.D. Tenn. 1994) (holding that truck drivers were independent contractors under

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The 1996 Act provided significant modifications of the independent contractor safe-harbor provisions contained in section 530. The 1996 Act also strongly affected several related issues.

Historically, the IRS had taken the position that section 530 does not apply unless the IRS first determines that a worker qualifies as an employee under the common law test. The 1996 Act made clear that section 530 applies irrespective of whether the IRS has made a determination of a worker's status under the common law test and, moreover, requires the IRS to first determine whether section 530 applies before considering the common law test.

In addition, the 1996 Act provides that when the IRS audits a taxpayer and identifies a possible worker-classification issue, it must provide the taxpayer with a written notice that explains section 530. The burden of proof in section 530 cases is also shifted from the taxpayer to the government. Once a taxpayer establishes a *prima facie* case that it was reasonable to classify a worker as an independent contractor, the burden of proof shifts to the IRS to prove that the taxpayer is not eligible for section 530. The burden of proof shifts for all aspects of section 530 except the issue of whether a taxpayer has demonstrated a reasonable basis "in some other manner."

For the burden of proof to shift, a taxpayer must fully cooperate with reasonable requests by the IRS for information relevant to the issue. The 1996 Act indicates that a request for information by the IRS will not be treated as "reasonable" if the information requested does not relate to the taxpayer's basis for claiming section 530 protection, or if compliance would be impracticable to the taxpayer given the particular circumstances and the relative costs involved.

§ 24.2.3(a)(ii)

Limitations on Section 530

Section 530 is subject to important limitations. For example, section 530 applies to the business only and not to the worker. This means that while section 530 protects a company that satisfies its requirements against any federal employment tax liability with respect to a worker, section 530 does not provide the worker with any such protection.

Thus, if a worker were determined to be an employee of a business under the common law test, but the business is eligible for protection under section 530, the business would not be liable for any federal employment taxes with respect to the worker, but the worker would remain liable for the employee share of FICA taxes on compensation received from the business. The employer share of FICA taxes would not be paid. On the other hand, if the worker were determined to be an independent contractor, the worker would be liable for the full amount of FICA taxes on compensation received from the business.

Section 530 is also limited to only federal employment taxes, and not to federally regulated Employee Retirement Income Security Act (ERISA) employee benefit plans. The primary significance of this limitation is its potential effect on the employee benefit plans maintained

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section 530's industry-practice safe-harbor provision); *World Mart v. United States*, 1992 U.S. Dist. LEXIS 19809, 93-1 U.S. Tax Cas. (CCH) ¶ 50,304 (D. Ariz. 1992) (holding that a telemarketing service exclusively employing individuals with disabilities was entitled to treat probationary workers as independent contractors until end of probationary period); *Henderson v. United States*, 1992 U.S. Dist. LEXIS 2423, 92-2 U.S. Tax Cas. (CCH) ¶ 50,357 (W.D. Mich. 1992) (denying independent contractor status to workers at tool-grinding facility under safe-harbor provisions).

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by a company. If a company was eligible for section 530 protection with respect to a group of workers, but the workers were determined to be employees under the common law test, the workers would be treated as employees for purposes of the company's benefit plans.

Section 1706 of the Tax Reform Act of 1986 (the provision is commonly referred to as "section 1706") excludes from section 530 protection for technical personnel who provide services for a business through a third party. *Technical personnel* are defined as engineers, designers, drafters, computer programmers, systems analysts, and other similarly skilled workers engaged in a similar line of work.

Thus, if a business contracts with a firm to provide a computer programmer to perform services and the business classifies the programmer as an independent contractor, section 1706 denies the section 530 protection with respect to its classification of the programmer as an independent contractor because: (1) the worker qualifies as a "technical" worker; and (2) the worker is engaged through a third party. By contrast, if the business were to engage the programmer directly, section 1706 does not apply and section 530 protection could be available.

Other limitations remain controversial. For example, it is unclear whether section 530 applies to a state or local government agency[34] or corporate officers.[35]

§ 24.2.3(b)

Form 1099 Reporting Requirement

A business satisfies section 530's Form 1099 reporting requirement if it reports on a Form 1099 the amount of compensation it paid each worker who earned at least $600 during the calendar year at issue.[36]

An important issue under this requirement concerns the reporting obligations of a taxpayer who contracts with a worker to perform services for a client, where the worker is paid by the client (instead of by the taxpayer). Under those circumstances, the issue is whether the taxpayer could qualify for section 530 protection without reporting the amount of compensation paid the worker on the grounds that the taxpayer had no duty to report amounts that it did not pay.

That precise issue was addressed in *Marlar, Inc. v. United States*,[37] *Taylor Boulevard Theatre v. United States*,[38] and *Cinema Art Theatre of Springfield, Inc. v. United States*.[39] Each case involved a club that contracted with exotic dancers to perform services for patrons of the club. In those cases, the clubs conceded that they did not report any payments made to

[34] *See* I.R.S. Tech. Adv. Mem. 94-43-002 (Dec. 3, 1993).

[35] However, in Chief Counsel Advice Memoranda 200038045 (Aug. 9, 2000), the IRS reached the conclusion that such officers may be excluded under section 530 if they were consistently treated as contractors, received IRS Form 1099-MISC and there was a reasonable basis for such treatment.

[36] Rev. Proc. 85-18 also requires Form 1099 to be timely filed. Although at least one court has criticized this requirement, businesses are still advised to timely file required returns in order to avail themselves of the section 530 safe harbor. *See Medical Emergency Care Assocs*., *S.C. v. Commissioner*, 120 T.C. 436 (2003).

[37] 151 F.3d 962 (9th Cir. 1998).

[38] 98-2 U.S. Tax Cas. (CCH) ¶ 50,521 (W.D. Ky. 1998).

[39] 99-1 U.S. Tax Cas. (CCH) ¶ 50,424 (C.D. Ill. 1999).

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the dancers on Form 1099s, but claimed they had no duty to do so because the dancers were paid solely by the customers.

In *Marlar*, each dancer signed a "Dancer Performance Lease" requiring dancers to pay a fee to the club, as landlord, for the privilege of dancing at the club. Dancers earned income in three ways: (1) cash for private dances; (2) "Extasy Bucks" for private dances, which customers purchased from the club with credit cards; or (3) a $10 club credit against the dancer's lease fee for each lady's drink purchased for a dancer. Dancers could redeem Extasy Bucks for cash from the club, but the club retained a 10% service charge.

The government conceded that a customer's cash payment to a dancer did not constitute a payment by the club. With respect to the other two forms of compensation, the court reasoned:

> [A] transferor of funds does not make a "payment" when it acts as a mere conduit or disburser of the funds. If, for example, the dancer asks the club to cash a check or to exchange two $10 bills for a 20, the club clearly has made no "payment" for the purposes of triggering a Form 1099 reporting requirement.

As applied to the facts in the case, the court concluded that the Extasy Bucks are:

> functionally no different than cashing a check or asking for change. In either case, the club was a mere disburser of funds; it did nothing more than exchange one item of value for another. The club did not have any meaningful influence over the amount of income that the dancers received from the customers . . . . Because the club was simply a financial intermediary — scarcely more significant than a messenger transferring the cash from customer to dancer — the club made no "payments" when it exchanged cash for the [Extasy Bucks].

The court characterized the 10% fee charged by the club for converting Extasy Bucks into cash as a mere check-cashing fee, and not affecting its analysis. The court viewed the club's involvement in crediting an amount for each lady's drink against a dancer's lease-fee as substantially equivalent to Extasy Bucks, reasoning that the club operated as a mere conduit of funds.[40]

In *Taylor*, the club charged dancers a nightly lease fee consisting of a fixed "minimum-shift rent" plus a percentage of the amount earned from each private dance. After a dancer's shift, the dancer paid the club its percentage of private-dance fees. The club kept track of the number of private dances each dancer performed. In this club, customers paid dancers only in cash.

The court rejected the government's contention that the club made payments to the dancers based principally on *Manchester Music Co. v. United States*.[41] The taxpayer in *Manchester* placed coin-operated vending machines in business premises. The machine operator and premise owners agreed to split the proceeds from the vending machine. The court concluded

[40] However, if the business appropriates the payments, uses funds to pay off its expenses, and claims deductions before remitting the remainder to the worker, the business does not qualify for section 530 protection. *Western Mgmt., Inc. v. United States*, 45 Fed. Cl. 543 (Ct. Fed. Cl. 2000).

[41] 733 F. Supp. 473 (D.N.H. 1990).

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that inasmuch as all proceeds were to be divided pursuant to a specified percentage, neither could be deemed to have made a "payment" of a portion of the proceeds to the other.

Applying the *Manchester* decision to the facts in *Taylor*, the court reasoned that since the club's and the dancers' respective share of the fees earned from private dances was defined by contract, neither party could be deemed to have paid the other its share of the fees.

In each case, the court held that the club made no payments to the dancers, had no duty to report on Form 1099s any amounts earned by dancers, and therefore, did not violate the Form 1099 requirement of section 530 with respect to the dancers.

The *Marlar* and *Taylor* decisions have important implications for any business that contracts with a worker to perform services for a third party, where the third party (and not the taxpayer) pays the worker. *Marlar* stands for the proposition that the taxpayer can rely on section 530's safe harbor without reporting on a Form 1099 any amounts the third party paid to him or her.

Subsequently, a similar case brought by the IRS resulted not only in a decision in favor of the taxpayer but also an award of attorneys' fees, with the court finding that the IRS was not justified in pursuing its claim.[42]

In an interesting Chief Counsel Advisory (CCA), the IRS concluded that a bail bond company satisfied the Form 1099 reporting requirement even though it did not report any commission amounts earned by its soliciting agents.[43] According to the ruling, customers paid the gross premium on a bail bond directly to the agent, and the agent remitted to the company only a net amount, after subtracting the agent's commission. Since the bail bond company did not "pay" any amounts to the agents, it had no reporting duty for purposes of section 530.[44] What makes the ruling interesting is that even though the Form 1099 requirement was deemed satisfied for purposes of section 530, the IRS concluded that the bail bond company could be subject to a penalty under Code section 6041(a) for failing to comply with the underlying Form 1099 requirement, which applies without regard to section 530.

§ 24.2.3(c)

Consistency Requirement

Finally, for all periods ending after December 31, 1977, the business must have treated all other workers holding substantially similar position as the worker in question as independent contractors. This is known as the *consistency requirement*. The IRS defined the term *treat* as the treatment of workers for purposes of federal tax laws.[45]

§ 24.2.3(c)(i)

No De Minimis *Exception*

In *LA Nails v. United States*,[46] a taxpayer leased a salon and engaged manicurists as independent contractors to perform services. In defense against an IRS challenge to the

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[42] *Déjà vu-Lynnwood, Inc. v. United States*, 21 Fed. App'x 691 (9th Cir. 2001).

[43] I.R.S. Chief Counsel Advisory 50035 (Dec. 17, 1999).

[44] *Id.*

[45] Rev. Proc. 85-18, 1985-1 C.B. 518.

[46] 98-1 U.S. Tax Cas. (CCH) ¶ 50,438 (D. Md. 1998).

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independent contractor classification, the taxpayer sought section 530 protection. The court rejected the taxpayer's claim, finding that the position held by one manicurist who the salon treated as an employee was "substantially similar" to the positions held by the manicurists that were treated as independent contractors. The case illustrates the rigidity with which the consistency rule can be applied.

Other courts have been more flexible in differentiating classes of workers. The application of section 530 to commonly-owned businesses arose in the cases *North Louisiana Rehabilitation Center, Inc. v. United States*,[47] and *Kentfield Medical Hospital Corp. v. United States*.[48]

In *North Louisiana*, the operator of a for-profit hospital contracted with physicians who served as medical and program directors under independent contractor agreements. The court found that similarly situated workers who had been employed by one employer were engaged on a full-time basis, had their schedules dictated by their employer, and worked exclusively for their employer. The independent contractors engaged by another related employer spent far less time, principally acted as consultants and maintained private practices. Not only were the positions distinguishable, but the IRS also applied the consistency factor separately for each corporation. The court ruled in favor of section 530 protection.

In the *Kentfield* case, the *de minimis* rule limitations are well illustrated. There, the director of psychological services had been hired as an employee and then became a contractor. Other psychologists were treated as contractors. While the court applied the consistency requirement separately with respect to each psychologist, the court also required consistency throughout the business relationship and even a short-term difference violated the substantive consistency requirement.

The holding of the *Kentfield* decision was more stringent than the IRS position, as articulated in Chief Counsel Advisory 200211037 (2002), wherein the IRS applied the consistency requirement separately with respect to each year. Nevertheless, when read together, these cases illustrate that section 530 relief should be considered separately for each legal entity.

Flexibility within a single organization can be found in *Select Rehab, Inc. v. United States*,[49] which involved the status of medical directors. In this case, separate medical directors were treated differently. The court found the employee-directors were not substantially similar to the contractor-directors, because the employees did not maintain private practices, worked substantially full-time and were subjected to significant supervision and control. While the functions of the positions were similar, the "environmental" circumstances were distinguishable.

§ 24.2.3(c)(ii)

State-Law Treatment Irrelevant

Treating a worker as an employee under state laws would not violate the consistency requirement. In Private Letter Ruling 93-38039 (June 29, 1993), for example, the IRS ruled that the payment of state unemployment taxes and the withholding of state income taxes did not violate the consistency requirement, so long as the compensation paid the worker was not reported on the federal Form W-2 and the worker was otherwise treated as an independent

[47] 179 F. Supp. 2d 658 (W.D. La. 2001).

[48] 215 F. Supp. 2d 1064 (N.D. Cal. 2002).

[49] 205 F. Supp. 2d 376 (M.D. Pa. 2002).

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contractor for purposes of federal taxes.[50] The IRS Training Guidelines confirm that the treatment of a worker for state unemployment tax or state withholding tax purposes does not affect the applicability of section 530. Similarly, at least one state court has held that state is not bound by section 530 classifications at the federal level.[51]

§ 24.2.3(c)(iii)

Predecessor Businesses

The Training Guidelines state that the consistency requirement also applies to a predecessor business.[52] Thus, for example, if a proprietorship treats couriers as employees and later is incorporated, the incorporated business could not qualify for section 530 protection with respect to couriers because its predecessor (the proprietorship) treated that same type of workers as employees.

§ 24.2.3(c)(iv)

Identifying "Substantially Similar" Workers

Whether one worker is *substantially similar* to another is a factual issue. In Revenue Ruling 87-41, 1987-1 C.B. 296, the IRS indicated that the determination "requires an examination of all the facts and circumstances, including particularly the activities and functions held performed by the individuals." As discussed above, the determination may be intensely subject to subtle factual distinctions.[53]

The 1996 Act clarified that for purposes of determining whether a worker holds a position that is substantially similar to another worker, one of the factors to consider is the relationship of the parties, including the degree of the company's supervision and control.

§ 24.2.3(d)

Establishing a Reasonable Basis for Section 530 Protection

Reasonable basis can be established by showing that the classification of a worker was in reasonable reliance on any of the following:

- acceptable precedent;[54]
- a prior IRS audit;[55]
- industry practice;[56] or

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[50] *Accord* I.R.S. Tech. Adv. Mem. 93-36005 (June 2, 1993).

[51] *Crew One Prods., Inc. v. State*, 149 S.W.3d 89 (Tenn. Ct. App. 2004).

[52] *See also* Rev. Proc. 85-18, 1985-1 C.B. 518.

[53] *See also Lambert's Nursery & Landscaping v. United States*, 894 F.2d 154 (5th Cir. 1990) (holding that janitorial workers were substantially similar to landscape workers for purposes of section 530 because the business's relationship with both types of workers was the same). *But cf. World Mart, Inc. v. United States*, 93-1 U.S. Tax Cas. (CCH) ¶ 50,304 (D. Ariz. 1992) (finding that probationary telemarketers not substantially similar to nonprobationary permanent telemarketers).

[54] Revenue Tax Act of 1978, § 530(a)(2)(A), Pub. L. No. 95-600, 92 Stat. 2763 (Nov. 6, 1978).

[55] *Id.* § 530(a)(2)(B).

[56] *Id.*

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- other reasonable basis.

The IRS acknowledges that Congress intended the reasonable basis standard to be construed liberally in favor of the taxpayer.[57] Each reasonable basis is discussed separately below.

§ 24.2.3(d)(i)

Acceptable Precedent

A taxpayer can establish a reasonable basis based on acceptable precedent if the taxpayer can cite to judicial precedent or a published ruling that supports its classification of the worker at issue as an independent contractor. In addition, a taxpayer may rely on a technical advice memorandum or a private letter ruling that is issued to that specific taxpayer.

§ 24.2.3(d)(ii)

Prior IRS Audit

A prior IRS audit consists of a past IRS audit of the business in which there was no assessment attributable to the treatment of individuals holding positions substantially similar to the position held by the worker at issue.

The 1996 Act made it more difficult for a taxpayer to establish a reasonable basis premised on a prior IRS audit. Under the Act, an IRS audit commencing after December 31, 1996, can be relied upon to establish a reasonable basis under section 530 only if the taxpayer can demonstrate that the audit included a determination of whether the specific worker involved, or a worker holding a substantially similar position, was properly classified as an independent contractor.

§ 24.2.3(d)(iii)

IRS Audit of a Predecessor

The IRS determined that a business can establish a reasonable basis for purposes of section 530 based on an IRS audit of a predecessor business.[58]

The Training Guidelines indicate that an IRS audit of a predecessor business will not satisfy the prior IRS audit safe harbor, but that a taxpayer's reliance on such an audit might constitute reasonable basis established "in some other manner."

§ 24.2.3(d)(iv)

Does a "Compliance Check" Constitute an Audit?

A significant administrative issue relating to the prior IRS audit safe harbor involves an *IRS compliance check.* For several years, the IRS has been contacting taxpayers in order to perform what the IRS representative describes as a compliance check. The IRS representative generally assures the taxpayer that a compliance check is not an audit, but merely a summary

[57] Rev. Proc. 85-18, 1985-1 C.B. 518.

[58] Rev. Rul. 83-152, 1983-2 C.B. 172; *see also World Mart*, *Inc.*, 93-1 U.S. Tax Cas. (CCH) ¶ 50,304 (holding that an audit of four out of five brother-sister corporations that all were engaged in the same business could constitute a reasonable basis for purposes of establishing section 530 protection for all five corporations).

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examination to determine whether the taxpayer complies with the record-keeping and information-reporting requirements that are imposed under the Code.

Taxpayers complained that the compliance check commonly exceeded its scope and, as part of the examination, the IRS representative would seek to ascertain whether the taxpayer had misclassified workers as independent contractors. Based on the taxpayer's responses, the IRS would either drop the issue (if the information indicated that the workers were properly classified) or convert the proceeding into an audit (if the information indicated that the workers might be misclassified). The procedure, taxpayers assert, is in substance an audit. Taxpayers contend that they should be allowed to rely on a compliance check for purposes of establishing protection under section 530 if the examination took into account the worker classification issue.

However, the IRS traditionally has refused to treat a compliance check as an IRS audit. In June 1995 the IRS released guidance making clear that a compliance check is limited to a review of information forms that the IRS requires a taxpayer to file or maintain. The guidance states that taxpayers are not to be questioned about particular liabilities or about worker classification issues. Furthermore, a compliance check will evolve into an audit —which can be relied upon by the taxpayer for the purpose of establishing protection under section 530 — if the IRS questions the taxpayer about worker classification issues.

§ 24.2.3(d)(v)

Industry Practice

The industry-practice safe harbor requires a showing of a "long-standing" recognized practice of a "significant segment" of the industry in which the type of worker at issue is classified as an independent contractor.

Significant segment is defined as 25% or more of an industry.[59] The term *long-standing* is defined as a practice that has been in existence for ten years or more.[60] A lower percentage or a shorter time period may still qualify, depending on particular facts and circumstances.[61]

§ 24.2.3(d)(vi)

What Is the Industry?

An industry practice for purposes of section 530 is determined by taking into account only those other businesses that are engaged in a similar type of business in the same geographic area as the company.[62] For example, to determine if a trucking company conforms with industry practices, it is compared with other operator businesses and not large ICC carriers.[63]

A critical requirement of the industry-practice safe harbor provision is that the taxpayer is affirmatively aware of the industry practice at the time that it decides to treat workers as independent contractors. The IRS reasons that a taxpayer cannot rely on an industry practice

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[59] Revenue Tax Act of 1978, § 530(e)(2)(B).

[60] *Id.* § 530(e)(2)(C)(i).

[61] IRS Training Guidelines, at 1-28.

[62] *General Inv. Corp. v. United States*, 823 F.2d 337 (9th Cir. 1987).

[63] *Sanderson v. United States*, 862 F. Supp. 196 (N.D. Ohio 1994), *order vacated & complaint dismissed*, 876 F. Supp. 938 (N.D. Ohio 1995).

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unless it knows the practice exists. One of the best ways to demonstrate knowledge of an industry practice is to undertake a survey.

In *303 West 42nd St. Enterprises v. IRS*,[64] the taxpayer unsuccessfully sought to have the trial court set aside a jury verdict involving the tax status of "fantasy booth" performers. The New York City taxpayer offered the testimony of New Jersey club owners that it was the industry practice in New Jersey to treat such performers as independent contractors. The taxpayer also relied on a prior IRS audit and advice received from an accountant. The taxpayer contended that the evidence established a reasonable basis. The court found that New Jersey club owners operated in a different geographic region from New York City. Therefore, testimony from New Jersey club operators could not establish the industry practice in New York City. Furthermore, the accountant's advice largely relied on industry information provided by the taxpayer with respect to other businesses the taxpayer also owned. The accountant, when offering his opinion, did not have access to all relevant information. As to the audit, the court found it questionable that there was actual reliance on the audit when the taxpayer engaged the dancers.

The case illustrates the importance of a thorough investigation of industry practices before setting up a business. Additionally, it is important to maintain good documentation of industry practices and to provide any professionals from whom you are seeking advice with full and complete disclosure.

§ 24.2.3(d)(vii)

Reasonable Reliance of Industry Practice

As is true for each of the "reasonable bases" that can be used to satisfy section 530, a taxpayer's reliance on a basis must be reasonable. In *Marlar, Inc. v. United States*, an exotic dancing club claimed that its treatment of dancers as non-employees was based on the practice followed by a significant segment of its industry.[65] Although the district court found that "virtually the entire industry treats dancers as lessees" within the Seattle area, it interpreted section 530 to require reliance on the industry practice be "reasonable."

In concluding that the club's reliance was reasonable, the appeals court was influenced by: (1) the fact that the district court could not determine the dancers' status under the common law test; and (2) the fact that the district court found many aspects of the dancers' relationship with the club to weigh in favor of their non-employee status. Chief among such findings were that dancers:

- exercised discretion in deciding for whom, when, and how to perform;

[64] 2000 U.S. Dist. LEXIS 6922 (S.D.N.Y. May 22, 2000).

[65] 151 F.3d 962 (9th Cir. 1998). However, it is important to determine whether industry practice has changed. For instance, since *Marlar* was decided, several courts have held that exotic dancers are employees, not independent contractors. *See Clincy v. Galardi S. Enters.*, 2009 U.S. Dist. LEXIS 78845 (N.D. Ga. Sept. 2, 2009) (granting temporary restraining order to exotic dancers who were terminated from their employment two weeks after alleging nightclub violated FLSA by misclassifying them as independent contractors and failing to pay proper wages); *Smith v. TYAD, Inc.*, 209 P.3d 228, 235 (Mont. 2009) (noting that the Independent Contractor Central Unit's determination that the dancers were employees became the "law of the case").

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- had the right to not perform any personalized dances during a given night; and
- negotiated their own fees for dances, and the nature of the dance to be performed with customers.

§ 24.2.3(d)(viii)

Industry Practice Not Required to Be Homogeneous in All Respects

Another litigated issue involves the degree of similarity required between the taxpayer's classification of worker and the industry's classification.

In *Taylor Blvd. Theatre, Inc. v. United States*,[66] an exotic dancing club was determined to have a reasonable basis for treating dancers as non-employees based on a showing that a significant segment of its industry treated dancers as non-employees. The court reached its decision based on: (1) court cases finding such an industry practice;[67] (2) affidavits of industry veterans that confirmed the industry practice of treating dances as non-employees; and (3) findings that the club had consulted legal and accounting experts who opined that the dancers were correctly classified as non-employees.

The court rejected an interpretation of the industry practice safe harbor offered in *303 West 42nd St. Enterprises v. IRS*,[68] as demanding that the industry treats all workers consistently, either all as independent contractors or all as lessees. According to *Taylor*, a taxpayer needs to show only that the industry treats the workers as *non-employees*. The Second Circuit reversed the district court's decision in *303 West 42nd St. Enterprises*, holding that a taxpayer can establish an industry practice — even if one part of an industry treats similar workers as non-employees for a different reason — so long as the specific practice relied on by the taxpayer is followed by a significant segment of the industry.[69]

§ 24.2.3(d)(ix)

Industry Survey Essential for Establishing Industry Practice

Options for Senior Americans Corp. v. United States[70] involved a Maryland corporation licensed to refer self-employed, nonskilled home aides to provide services for the elderly. The court found that the business, before commencing operations, conducted a survey of 20 to 30 competitors in the metropolitan Washington, D.C. area that referred unskilled personal-care aides to clients. The survey indicated that approximately 80% of the responding agencies treated the aides as independent contractors, while 10% treated the aides as employees. The remaining 10% did not respond. Subsequently, the business opened offices in Baltimore, Maryland, and Northern Virginia. The business conducted similar surveys in those specific areas and continued to survey its competitors at regular intervals. The court found the subsequent surveys yielded comparable results. The court held the survey information compiled by the business was sufficient to establish a reasonable basis under section 530 for treating the nonskilled home aides as independent contractors.

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[66] 98-2 U.S. Tax Cas. (CCH) ¶ 50,521 (W.D. Ky. 1998).

[67] *See*, *e.g.*, *JJR*, *Inc. v. United States*, 950 F. Supp. 1037 (W.D. Wash. 1997), *aff'd*, 156 F.3d 1237 (9th Cir. 1998); *Marlar*, *Inc. v. United States*, 934 F. Supp. 1204 (W.D. Wash. 1996), *aff'd*, 151 F.3d 962 (9th Cir. 1998).

[68] 916 F. Supp. 349 (S.D.N.Y. 1996), *rev'd and remanded by* 181 F.3d 272 (2d Cir. 1999).

[69] 181 F.3d 272 (2d Cir. 1999).

[70] 11 F. Supp. 2d 666 (D. Md. 1998).

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In Technical Advice Memorandum 96-19001 (May 1, 1996), the IRS rejected a claim of section 530 protection by an individual who started a courier business and treated the couriers as independent contractors. The IRS reasoned that the individual neglected to conduct a survey of other courier companies in its market to determine the industry practice. This ruling is noteworthy because the individual had worked for six different courier companies in the same metropolitan area prior to starting his own business. The IRS characterized that experience as insufficient evidence of his knowledge of industry practice.

§ 24.2.3(e)

Establishing Reasonable Basis in Some Other Manner

Demonstrating reasonable basis "in some other manner" is limited only by the creativity of a taxpayer and its advisors. Courts have held that a taxpayer can establish reasonable basis by demonstrating a reasonable interpretation of the common law test.[71]

While the IRS originally did not agree with the foregoing decisions, the Training Guidelines now acknowledge that a business that makes a reasonable effort to establish independent contractor treatment for its workers under the common law, but falls just short of satisfying the common law standard, may be protected by a valid section 530 safe harbor.

The Training Guidelines confirm that reliance on the advice of an attorney or accountant can constitute a reasonable basis.[72] The Training Guidelines state that while a business need not independently investigate the credentials of the tax adviser, it should, at a minimum, establish that it reasonably believed the adviser to be familiar with business tax issues and that the advice was based on sufficient relevant facts. The Training Guidelines also state that the advice must have been provided when the treatment of the affected workers as independent contractors began, and that advice given after the treatment began would *not* suffice. In *Select Rehabilitation*, *Inc. v. United States*, the court held that reliance on the advice of the taxpayer's own legal department provided a reasonable basis.[73] Furthermore, against the IRS's contention that the taxpayer would need to present evidence of specific advice given, the court determined that the only requirement is the taxpayer's reliance on advice of counsel itself. Despite this decision, it is advisable that taxpayers establish that there was actual review and consideration of the relevant facts and that tax advisors were experienced with such matters. Such records may allow taxpayers to persuade the IRS at the administrative level so to avoid litigation.[74] However, it is worth noting that at least one court has held that a taxpayer cannot rely upon advice from an accountant to establish "reasonable basis."[75] One of the more novel victories that taxpayers obtained was in *Queensgate Dental Family Practice, Inc. v. United States*. The taxpayer was a professional corporation under state law, which also

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[71] *Critical Care Registered Nursing*, *Inc. v. United States*, 91-2 U.S. Tax Cas. (CCH) ¶ 50,481 (E.D. Pa. 1991); *Hospital Res. Pers. v. United States*, 68 F.3d 421 (11th Cir. 1995); *American Inst. of Family Relations v. United States*, 79-1 U.S. Tax Cas. (CCH) ¶ 9364 (C.D. Cal. 1979).

[72] *See also Smoky Mt. Secrets v. United States*, 910 F. Supp. 1316 (E.D. Tenn. 1995) (finding that the taxpayer exercised "ordinary business care and prudence" by seeking and relying on the opinion of two CPAs).

[73] 205 F. Supp. 2d 376 (M.D. Pa. 2002).

[74] See also *Ewen & Miller*, *Inc. v. Commissioner*, 117 T.C. 263 (2001) where the court simply disregarded the petitioner's reliance on the advice of counsel and found no other reasonable basis for section 530 relief presented.

[75] *In re Arndt*, 201 B.R. 853 (M.D. Fla 1996). *See generally United States v. Boyle*, 469 U.S. 241, 252 (1985) (holding that the taxpayer's good faith reliance on advice of tax attorney or accountants was not a sufficient defense).

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prohibited a professional corporation from employing dentists unless all the outstanding stock of the corporation was owned by dentists.[76] The taxpayer argued that it could not employ dentists because some of its shareholders are not dentists. Therefore, the dentists are contractors and not employees. The court agreed and held that the state statute provided the corporation with a reasonable basis under section 530 for classifying the dentists as independent contractors.[77]

In *Peno Trucking, Inc. v. Commissioner*, the Sixth Circuit Court of Appeals also found that it was reasonable for a trucking company to rely upon state administrative rulings that applied a common law test that was virtually identical to the federal common law.[78] The case is significant because it reaffirms the right to section 530 tax relief based on a reasonable reliance upon the common law independent contractor factors, even if those factors are established by a state agency or court.

§ 24.2.3(f)

Real Estate Agents' Statutory Independent Contractor Status

The Tax Equity and Fiscal Responsibility Act of 1982 deemed real estate agents to be statutory independent contractors.[79] Under Code section 3508(b)(1), a real estate agent is an independent contractor if all of the following conditions are satisfied:

- The individual is a licensed real estate agent working as a salesperson.
- Substantially all of the individual's remuneration for services performed as a real estate agent is directly related to sales or other output (including the performance of services) rather than to the number of hours worked.
- The individual's services are performed pursuant to a written contract with the service recipient that identifies the individual as an independent contractor.

The application of the foregoing provisions has not stirred much controversy. However, in Technical Advice Memorandum 94-24003 (June 17, 1994), the IRS concluded that a real estate appraiser did not qualify for the statutory protection because appraisers are not sellers. The taxpayer had relied on Proposed Treasury Regulation section 31.3508-1(b)(2), which allows a real estate seller to qualify notwithstanding that the individual also performs some appraisal services. The IRS stated in the technical advice memorandum that the appraisal services must be *incidental* to the selling services. If the appraisal services were predominant rather than incidental to real estate sales, the appraiser would be ruled ineligible for protection under Code section 3508(b)(1).

In Technical Advice Memorandum 96-48003 (Nov. 29, 1996), the IRS ruled that loan officers did not qualify as statutory independent contractor, notwithstanding that the applicable state law defined the term *real estate salespersons* to include loan officers. The IRS reasoned that

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[76] 91-2 U.S. Tax Cas. (CCH) ¶ 50,536 (M.D. Pa. 1991).

[77] *Contra* I.R.S. Priv. Ltr. Rul. 93-21001 (Feb. 1, 1993) (rejecting a taxpayer's effort to obtain section 530 protection based on the *Queensgate* decision because state law did not supplant the common law test by federal statutes).

[78] 296 Fed. App'x 449 (6th Cir. 2008.)

[79] Some real estate agents have also been held to be independent contractors for purposes of Title VII after the Supreme Court's decision in *Clackamas Gastroenterology Assocs., P.C. v. Wells*, 538 U.S. 440 (2003). *See Kakides v. King Davis Agency, Inc.*, 283 F. Supp. 2d 411 (D. Mass 2003).

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the treatment under state law of a loan officer is not controlling for purposes of Code section 3508. The IRS determined that loan solicitation is not an activity that is customarily performed by real estate agents. Consequently, the IRS concluded that the loan officers were not eligible for coverage under Code section 3508.

§ 24.2.3(g)

Direct Sellers' Statutory Independent Contractor Status

Code section 3508(b)(2) provides that an individual qualifies as a *direct seller* — and therefore is by statute an independent contractor — if the following criteria are satisfied:

- the individual is engaged in the trade or business of selling or soliciting the sale of selling consumer products:
  - to other buyers on a buy-sell basis, a deposit-commission basis, or any similar basis for resale by those buyers or by any other person in a home other than a permanent retail establishment; or
  - in a home other than a permanent retail establishment; and
- substantially all the remuneration for the performance of the services is directly related to sales or other output (including the performance of services) rather than to the number of hours worked; and
- the services are performed pursuant to a written contract with the service recipient that describes the individual as an independent contractor.

The definition of a *consumer product* appears to be expansive, including both tangible and intangible products.[80] However, one issue that remains controversial involves the type of activities that qualify as sales. The IRS ruled that canvassers and closers that solicited the sale of home improvements qualified as direct sellers for purposes of Code section 3508.[81] According to the facts of the ruling, canvassers made the initial visit to a potential customer and, if the visit was promising, the prospect was referred to a closer. The closer would follow up with another appointment and seek to close the sale. Canvassers were compensated based on the number of appointments scheduled, and closers' commissions were based on the dollar value of actual contracts. Both were ruled to qualify as direct sellers.

§ 24.2.3(h)

Newspaper Distributors & Carriers Statutory Independent Contractor Status

A person engaged in the trade or business of delivering or distributing newspapers or shopping news, including ancillary services such as soliciting customers or collecting receipts, now also qualifies as a statutory independent contractor, provided that: (1) substantially all the remuneration derived from the performance of services is directly related to sales or other output, rather than to the number of hours worked; and (2) the

[80] *See* I.R.S. Tech. Adv. Mem. 95-30-001 (Apr. 13, 1995) (home improvement projects qualify as consumer products); *R Corp. v. United States*, 94-2 U.S. Tax Cas. (CCH) ¶ 50,380 (M.D. Fla. 1994) (cable television subscriptions qualify as a consumer product); *Cleveland Inst. of Elecs., Inc. v. United States*, 787 F. Supp. 741 (N.D. Ohio 1992) (home study educational courses qualified as consumer products).

[81] I.R.S. Tech. Adv. Mem. 95-30-001 (Apr. 13, 1995).

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services are performed pursuant to a written contract between the person and the service recipient that provides that the person will not be treated as an employee for federal tax purposes. The statutory independent contractor status applies for purposes of income and employment taxes.

The statutory independent contractor status is intended to be available to newspaper distributors and carriers, whether or not they hire others to assist in the delivery of newspapers. In addition, the statutory status is intended to apply to newspaper distributors and carriers who operate under either a buy-sell distribution system where the worker purchases the newspapers from the publisher for resale, or an agency distribution system where the worker is paid by the publisher based on the number of newspapers delivered.

§ 24.2.3(i)

Sitter-Referral Agencies' Statutory Independent Contractor Status

The sitter-referral safe harbor is a relatively obscure provision — except for the affected businesses. The provision applies to businesses that are engaged in referring sitters. *Sitters* are defined as individuals who are engaged to provide personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled.[82]

A business that refers sitters to clients shall not be treated as the sitters' employer for purposes of federal employment taxes. In addition, Code section 3506 states that the sitter shall not be treated as an employee of the business.

The safe harbor applies only if the following requirements are met:

- The business does not pay or receive the compensation paid the sitter.
- The business is compensated by the sitter or by the person who engages the sitter on a fee basis.

A critical factor in a referral agency's eligibility for protection under Code section 3506 is that the compensation for services performed must be paid to the sitter and not to the agency. For example, in Revenue Ruling 80-365, 1980-2 C.B. 300, the IRS concluded that sitters were employees of an agency if it billed the client, extracted a fee and, in turn, paid the sitters.

Code section 3506 applies only with respect to the relationship between the referral agency and the sitter; it does not apply to the relationship between the sitter and the client for whom the services are actually performed. Thus, a sitter could be deemed an employee of a client notwithstanding the application of Code section 3506.

§ 24.2.3(j)

Tax Court Jurisdiction for Determining a Worker's Status

For the past several years the Tax Court has had jurisdiction to decide both the IRS's reclassification as well as the IRS's calculation of employment taxes owed. Administrative guidance interpreting the Tax Court's expanded jurisdiction to hear worker-classification disputes has been most recently provided in Notice 2002-5, I.R.B. 2002-3, 320. According to the Notice, the only person eligible to bring an action under the law is an *engaging entity* that

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[82] I.R.C. § 3506(b) (2008).

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the IRS has determined to be: (1) the employer of a worker for federal employment-tax purposes; and (2) not eligible for relief under section 530 of the Revenue Act of 1978. The Tax Court still lacks jurisdiction concerning liability for federal employment taxes where professional employer organizations (PEOs) or other leasing arrangements have been utilized.

Persons *not* having a right to seek review under the law, according to the Notice, include: (1) workers; and (2) any potential employer that has not been determined by IRS to be the employer. This means that in a three-party employee-leasing arrangement, the only party authorized to bring an action under Code section 7436 would be a company that the IRS has determined to be the employer of a worker for federal employment tax purposes. Neither the affected worker nor the other entity involved in the arrangement has standing to sue in Tax Court.

The Tax Court has jurisdiction with respect to two issues only, whether: (1) an individual performing services for a taxpayer is an employee of the taxpayer for federal *employment* tax purposes; and (2) the taxpayer is eligible for relief under section 530. In either case, the issue must arise in the context of an IRS audit.

The Tax Court also has the jurisdiction to render decisions on any affirmative defenses. In *Neely v. Commissioner*, the taxpayer claimed that the assessment was barred by the statute of limitations (three years).[83] Based on allegations of willful tax avoidance, the IRS claimed there was no bar. The Tax Court determined that it had authority to resolve the statute of limitations question because it is an affirmative defense presented in a classification controversy.

Issues over which the Tax Court does *not* have jurisdiction include:

- a worker's status for federal *income* tax purposes, *e.g.*, for eligibility to participate in an employee benefit plan maintained by a taxpayer;
- income tax deductions to which a worker might be entitled;
- IRS determinations made in the form of a private letter ruling or in response to an IRS Form SS-8 inquiry unless they become part of the examination; or
- issues related to tax penalties.

When a matter becomes eligible for Tax Court review, the IRS will issue a *Notice of Determination*, which will describe a deficiency, explain the procedures for seeking review, and include a schedule of workers subject to reclassification and illustration of the proposed tax adjustment. The IRS will only issue a Notice of Determination if it determines that a taxpayer is the employer of a worker and that the taxpayer is not eligible for section 530 protection with respect to the worker. A taxpayer may not file a complaint at the Tax Court without first receiving a Notice of Determination.

Before a taxpayer receives a Notice of Determination, the taxpayer generally will have received a 30-day letter, which the IRS sends a taxpayer in a disputed case that lists the IRS's proposed adjustments. A taxpayer's options upon receipt of a 30-day letter include generally: (1) agreeing to the proposed adjustment; or (2) within 30 days of the date of the letter, filing a protest with IRS, seeking a review of the proposed adjustment by the IRS Appeals Division. If a taxpayer neither agrees to nor protests a proposed adjustment, the IRS will send the

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[83] 115 T.C. 287 (2000).

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taxpayer the Notice of Determination generally within 60 days of the date of the 30-day letter. If the taxpayer's case is before the IRS Appeals Division (either pursuant to a protest or under the IRS's early referral procedure for worker-classification disputes) and the case is not resolved, the taxpayer will receive a Notice of Determination after the end of that process.

Upon receipt of a Notice of Determination, the taxpayer must file a petition with the Tax Court within 90 days after the IRS mails the notice. If the taxpayer fails to file a timely petition with Tax Court, the taxpayer retains the right to file a request for refund with the IRS and, if denied, to pursue a refund action in a federal district court or in the Court of Federal Claims.

A case filed with the Tax Court will be referred to the IRS Appeals Division for settlement consideration unless the Notice of Determination was issued by the Appeals Division, in which event the case might be referred to the IRS Appeals Division depending upon the IRS District Counsel's evaluation of the prospects for the case being settled. The IRS Appeals Division will have sole settlement authority over such a case until the case is returned to District Counsel.

§ 24.2.4

D. LEASED EMPLOYEES & PEOs

Employee leasing firms and *professional employer organizations* (PEOs) are firms that contract with workers and refer or assign them to perform services for clients. These firms treat the workers as employees of the firm for certain purposes. Another type of firm within this category is a referral agency, which refers workers and treats the workers as independent contractors with respect to the firm. For purposes of this section of the chapter, the third-party firm that assigns or refers the worker is referred to as the *firm* and the company for which the worker performs services is referred to as the *client company*.

There are four possible arrangements when another firm is interposed between a worker and a client company:

1. worker is an employee of both the firm and the client company;
2. worker is an employee of the firm and an independent contractor of the company;
3. worker is an independent contractor of the firm and an employee of the client company; or
4. worker is an independent contractor of both the firm and the client company.

While the foregoing possibilities represent all the potential options for contingent workers, an arrangement can fall under different categories for purposes of different laws. For example, a worker may qualify as an independent contractor of both the firm and the client company for federal employment tax purposes, but qualify as an independent contractor of the firm and an employee of the client company for employee benefits purposes.

In determining the proper status under a specific law, a worker's status relative to the firm and relative to the client company generally must be determined separately. One significant exception to this general rule applies for purposes of certain labor and employment laws that define an employment relationship by taking into account a concept known as *joint employment*. This concept requires that both the firm and client company be considered together in determining whether a worker qualifies as an employee. Consequently, both may be jointly responsible.

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While both a PEO and an employee leasing firm assign workers to a client company, a PEO offers a client company an opportunity to effectively "outsource" its entire human resources function. A PEO can take over as employer (and assign back to the client company) a client company's entire workforce. An employee leasing firm, by contrast, commonly assigns to a client company workers that represent a smaller portion of the client company's entire workforce. From a legal analysis standpoint, however, both are variations on the same concept.

§ 24.2.4(a)

Benefits of Using a PEO

While most large corporations have the financial resources and expertise to maintain familiarity and compliance with the already vast, and growing, array of federal, state, and local employment-related laws and regulations, few small- and medium-sized businesses can afford to do so. PEOs offer small- and medium-sized businesses a solution by providing them with the services and expertise of a large, experienced personnel department. This, in turn, enables those businesses to concentrate on their core business, and thereby increase their profitability.

PEOs also can save companies money due to economies of scale. A PEO that employs thousands of workers can obtain more affordable health insurance rates and workers' compensation premiums than a small employer with, 50 employees, for instance. Moreover, PEOs often handle the benefits and human resource functions for scores of companies, and therefore are able to administer these functions more economically than the individual companies could. Certain ERISA issues affecting PEOs also are discussed below.

The benefits of utilizing a PEO often inure not only to the client-company but also to the company's workforce. For example, in many cases, employees will receive a greater quality and quantity of benefits from a PEO than they would receive from a small employer. This win-win arrangement is particularly valuable in competitive labor markets.

Although the benefits of PEOs outlined above are compelling, these firms, as well as traditional employee leasing firms, can also present significant legal risks to client companies and to the workers who contract with such firms if the arrangements are not structured carefully.

For purposes of most laws, the model that the parties commonly anticipate creating in an employee leasing/PEO arrangement is that of the worker being an employee of the firm, and an independent contractor of the client company. For the reasons discussed below, there are legal impediments that make it very difficult to establish those relationships without careful planning.

§ 24.2.4(b)

Transition to a Leased/PEO Workforce: Overview of Considerations

A leasing firm/PEO and client company that enter into a leasing arrangement should carefully consider all the ramifications of changing the employment relationship and the legal obligations it may trigger. This is particularly true in situations where most or all of the workers formerly employed by the client company are being hired by the firm and assigned back to fill the same job positions.

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If the parties hope to establish separate-employer status (*i.e.*, causing the workers to cease being employees of the client company and to commence employment with the firm), they should observe all of the regular formalities of such a transfer of employment. First, the change of employment status must be clearly communicated to all of the affected employees. The client company should formally lay off the employees, and the firm should hire them. The firm should comply with all normal hiring procedures, including the immigration-law requirements under the Immigration Reform and Control Act (IRCA). To the extent that client companies fail to respect the formalities of the change in employers, they will risk undermining separate-employer status.

The workers' transition from being employees of the client company to becoming employees of the firm can give rise to questions concerning fringe-benefit rights. One example would be whether or not transferred employees are entitled to severance pay under the client company's severance policy. Employees laid off by the client company, even if hired immediately by the firm, have severed their employment relationship with the client company. In such circumstances, affected employees could claim that the terms of the client company's severance plan entitle them to severance pay.[84]

Affected employees might also claim entitlement to other post-employment rights such as COBRA (Consolidated Omnibus Budget Reconciliation Act) health benefits or distributions from individual retirement accounts, profit sharing, stock purchase, and other benefit plans that the client company maintains.

After the transition, employees should receive final paychecks from the client company in compliance with standard company practice and state and federal law. The payments may include accrued commissions, vacation, sick pay, and other such benefits to the extent required upon termination. Although employees can be offered a cash payout of these monies or a carryover of the accrued rights to the new employer, a carryover policy may undermine separate-employer status.[85] The existence of employment rights based on seniority presents another problem. Allowing transferred employees to carry over seniority may undermine separate-employer status. On the other hand, potential morale problems may motivate parties to accept the risk.

If a client company is unionized, potential obligations to the union must be considered. A leasing firm may agree to assume all of the obligations under the client company's labor agreement. However, the client company will not necessarily be relieved of joint liability for the leasing firm's compliance unless the union agrees in writing to the assignment of the agreement and releases the client company. Further, the decision to lay off the workforce and to contract with a leasing firm may well trigger an obligation to bargain with the union over the effects of that action. In particular, a duty to negotiate with the union may be triggered if the decision to change to leased employees is based on labor costs.

The foregoing is certainly not an exhaustive list. In the process of transitioning from regular employees to leased employees, both the leasing firm and the client company must carefully

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[84] *See Blau v. Del Monte Corp.*, 748 F.2d 1348 (9th Cir. 1984), *cert. denied*, 474 U.S. 865 (1985) (holding that employees hired by the purchaser were entitled to severance pay under the terms of seller's severance plan despite the absence of any loss of employment).

[85] PEOs may also become liable for unpaid federal employment taxes if it has control over the payment of wages. *United States v. Total Empl. Co.*, 305 B.R. 333 (2004) held that even though the client company was the common law employer of the workers, the PEO was liable for unpaid federal employment taxes because it had control over the payments to the workers.

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observe the appropriate formalities and respect the rights of employees in employment termination with one company and hiring by another.

§ 24.2.5

E. IRS CRIMINAL PROSECUTIONS IN EMPLOYMENT TAX CASES

The IRS's Criminal Investigation Division (CID) continues to actively pursue an enforcement program aimed at criminally prosecuting those who intentionally evade their obligations to remit employment taxes. In particular, the IRS focuses on *pyramiding*, which is a fraudulent practice whereby taxes withheld from employees are intentionally not remitted to the IRS. The business files bankruptcy and then the principals create another business and continues the conduct.

United States v. Butler[86] exemplifies the IRS's aggressive pursuit under the criminal law. Butler operated a business with leased employees whose paychecks reflected deductions for taxes, but those taxes were not remitted and the appropriate tax returns were not filed. Butler claimed that the government had agreed not to prosecute him if he helped the government to locate and prosecute a business partner. The government denied the existence of an agreement. The court refused to dismiss the indictment because Butler failed to produce convincing evidence of such an agreement.

Additionally, the IRS is reviewing arrangements where turn-key operations provide the workers and payroll services and the leasing client company fails to remit withheld taxes. The IRS has also investigated arrangements involving cash payments to employees and intentional understatements on information returns (W-2) of wages paid. In recent years, the number of criminal investigations by the IRS has declined. However, the conviction rate has risen to around 90% with average prison terms of 20 years. Some worried that the IRS might try to "criminalize" the "misclassification" of independent contractors. In recent discussions with the IRS, it has indicated that it does not intend to do so. However, both state governments as well as the IRS have the ability to both civilly and criminally prosecute tax matters. In order to establish criminal liability, the government must prove beyond a reasonable doubt that the taxpayer willfully evaded its tax obligations. Nonetheless, businesses can avoid making themselves a target by carefully selecting reliable leasing firms. At the first sign that there may be a criminal investigation, businesses are strongly advised to retain qualified criminal defense counsel.

§ 24.2.5(a)

Federal Employment Tax Requirements

For purposes of FICA, FUTA, and federal income tax withholding, an employer is defined by the usual common law rules (*i.e.*, a person who has the right to direct and control a worker as to the details of when, where, and how work is to be performed). In arrangements involving an employee leasing firm/PEO, Code section 3401(d)(1) may play a prominent role in allocating federal employment tax obligations.

[86] 297 F.3d 505 (6th Cir. 2002).

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§ 24.2.5(a)(i)

General Rule

The status of workers in leasing transactions must be determined separately with respect to the leasing firm/PEO and the client company. For federal tax purposes, the worker's relationship with each is determined autonomously. For example, in *Vizcaino v. United States District Court*,[87] known as "the Microsoft case," the court stated that a worker need not be an employee exclusively of Microsoft or the leasing firm, but could be an employee of both or neither — the determination of a worker's status with respect to each is an independent inquiry. For purposes of certain labor and employment laws, both entities must be considered together to determine whether a "joint employment" relationship exists.

While it is especially difficult for a leasing firm/PEO to structure its relationship with a leased worker so the worker qualifies as an employee of the firm, CCA 99-37012 (Sept. 17, 1999) provides one example of where that feat was accomplished. The CCA involved a firm that was granted a lease of a medical institution and was engaged to operate it. The firm was ruled to qualify as the common law employer of the workers engaged by the firm to operate the institution. In a private letter ruling, the IRS identified the factors it considers most determinative in ascertaining whether a client company or a leasing firm is the common law employer of leased truck drivers.[88]

§ 24.2.5(a)(ii)

Control of the Payment of Wages Exception

Code section 3401(d)(1) provides an exception that supersedes the foregoing rules in circumstances where a worker performs services for (and is the common law employee of) one entity, but is paid by a different entity that has "control of the payment" of the wages. In those cases, the employer, for federal employment tax purposes, is the entity with control of the payment of wages. The *employer* under Code section 3401(d)(1) is treated as such for purposes of FICA, FUTA, and federal income tax withholding.[89]

Risk of Paying Wages Owed by Another

The application of this exception produced an unexpected result for a landowner who engaged sharecroppers to grow tobacco and who paid day laborers hired by the sharecroppers out of the landowner's own checking account. The landowner was held liable for FICA and FUTA taxes owed with respect to wages paid the day laborers.

The landowner at issue in *Winstead v. United States*,[90] engaged individuals to grow tobacco in exchange for the landowner providing the individuals with homes and equipment. The landowner also agreed to split the cost of ordinary expenses such as fertilizer and chemicals. After the tobacco was sold, the landowner and the sharecroppers would split the proceeds.

The sharecroppers hired migrant farm workers as day laborers to assist in the farming operations. Most of the sharecroppers could not afford to pay the migrant workers until the

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[87] 173 F.3d 713 (9th Cir. 1999), *cert. denied*, 528 U.S. 1105 (2000).

[88] *See* I.R.S. Priv. Ltr. Rul. 99-48-001 (Dec. 3, 1999).

[89] *See*, *e.g.*, *Otte v. United States*, 419 U.S. 43 (1974); *Consolidated Flooring Servs. v. United States*, 99-1 U.S. Tax Cas. (CCH) ¶ 50,434 (Fed. Cl. 1999).

[90] 109 F.3d 989 (4th Cir. 1997).

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tobacco was sold. In those cases, the landowner paid the migrant workers the wages owed them by the sharecroppers out of the landowner's own checking account.

The IRS assessed the landowner for unpaid FICA and FUTA taxes owed with respect to the wages paid to the migrant workers based on Code section 3401(d)(1). The court held that the landowner controlled the payment of wages to the migrant workers because the landowner paid the migrant workers' wages directly from its own checking account and the sharecropper had no access or authority over the landowner's account.

The court rejected the landowner's interpretation of Code section 3401(d)(1) — that it requires not only wage payments, but also control over hiring, firing, supervision, and the amount to be paid. The court observed that those factors are relevant in applying the common law test, but not Code section 3401(d)(1).

Winstead demonstrates the perils of paying the wages owed by another business. As a general rule, a taxpayer should never consider doing so unless it also intends to pay the applicable payroll taxes. A failure to withhold and remit taxes based on an erroneous assumption that the taxes are the responsibility of the other business can result in liability for the applicable federal employment taxes.

Application of Internal Revenue Code Section 3401(d)(1) to Leasing Arrangements

In arrangements whereby a client company engages a third party to assign or refer a worker, however, Code section 3401(d)(1) provides the parties with an ability to expressly allocate federal employment tax liabilities. To do so successfully, however, requires skillful structuring of the arrangement.

In Private Letter Ruling 98-25009 (June 19, 1998), the IRS relied on section 3401(d)(1) when it concluded that an agency that referred nurses to clients was liable for federal employment taxes on compensation received by the nurses, based on determinations that: (1) the nurses were common law employees of the clients; and (2) the agency retained "control of the payment" of compensation to the nurses.

The agency entered into written agreements with: (1) registered nurses, whereby the agency agreed to help the nurses find clients; and (2) clients, whereby the agency agreed to help clients find nurses. Under these agreements, the client would pay a gross fee to the agency, which in turn extracts its referral fee from the gross payment and pay the remaining portion to the nurse. The IRS found the discrepancy between the rate charged to the clients and rate paid to the nurses to be significant enough that the agency had "control of payment" and therefore was an employer for federal tax purposes.

As this private letter ruling illustrates, a principal area of federal employment tax exposure for agencies that refers independent contractors to clients is the control of the payment exception. From a planning perspective, a referral agency can structure its arrangement so that it does — or does not — "control" the payment of compensation to workers it refers.

A referral agency that does not control the payment of compensation to workers exposes its clients to federal employment tax liability in the event the client maintains a common law employment relationship with a referred worker. By contrast, a referral agency that controls the payment of compensation to the workers it refers assumes that risk itself.

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The application of Code section 3401(d) to a leasing arrangement allows the parties to allocate federal employment tax responsibilities to the firm, even if the firm fails to qualify as a common law employer, so long as the firm maintains control of the payment of wages to workers.

The leading case addressing the successful application of Code section 3401(d) — resulting in a leasing firm being held to control the payment of wages to workers — is *General Motors Corp. v. United States*.[91] In that case, the federal district court held that design engineers who were recruited by an overseas company to provide services for GM on GM's premises — but who were paid directly by the overseas company — were employees of the overseas company (and not of GM) for federal employment tax purposes. The court concluded that the overseas company, rather than GM, maintained control of the payment of wages because the overseas company issued paychecks to the workers, handled all administrative matters related to the workers, provided a representative to act as the supervisor of the workers, and applied for visas and handled all arrangements for the workers to move to the United States.

In addition, the court found that GM did not provide any health benefits to the workers, did not handle any personnel responsibilities for the workers, did not maintain any paperwork concerning the workers (except for information on whom to contact in the case of an emergency), was not aware of the amount of wages or fringe benefits being paid by the overseas company, and did not know how much profit the firm was earning under the arrangement.

The most critical factor to the court was the fact that GM did not know how much the workers were being paid. The absence of this knowledge, the court observed, precluded GM from having the ability to calculate the amount of payroll taxes owed with respect to the wages paid to the workers. Another key factor was that the overseas company was much more than a mere payroll service. The court found that even though GM was required to pay the overseas company its fees before it would be required to pay the workers, the overseas company still had control over the payment of wages.

The IRS further clarified the analysis for determining whether a leasing firm controls the payment of wages to leased workers. In CCA 99-32002 (Aug. 13, 1999), the IRS concluded that a leasing firm/PEO did not control the payment of wages to leased workers based principally on findings that the client company: (1) designated the payroll frequency; and (2) was required to provide the firm with the necessary funds to make payroll before the firm would pay the workers. The ruling appears to indicate that a critical factor in determining whether a leasing firm controls the payment of wages is whether it must rely on the client company to provide the funds to pay the wages.

Effect of Internal Revenue Code Section 3401(d)(1) on Wage-Base Limits

The amount of FICA taxes and FUTA taxes imposed with respect to an employee is limited by a statutory *wage base*. For FICA taxes, the OASDI portion of the tax (6.2%) is imposed only on the first $106,800 of wages paid an employee during 2010.[92] The Medicare (1.45%)

[91] 1990 U.S. Dist. LEXIS 17986, 91-1 U.S. Tax Cas. (CCH) ¶ 50,032 (E.D. Mich. 1990).

[92] *See* Contribution and Benefit Base, Social Security Online, http://www.ssa.gov/OACT/COLA/cbb.html.

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portion of the tax is imposed without limitation. FUTA taxes are imposed only on the first $7,000 of wages paid an employee during a calendar year.[93]

These limitations, referred to as *wage bases*, give rise to an important issue in the context of an employee leasing transaction, namely, whether the wage base is applied at the leasing firm level or at the client company level. The issue becomes especially complex when a client company is the common law employer of a worker, but the leasing firm is treated as the worker's employer for federal employment taxes by application of Code section 3401(d)(1). The result could have significant financial implications, particularly for workers who perform services through one leasing firm, but for several client companies, during a calendar year.

In IRS Chief Counsel Advisory 200017041 (Apr. 28, 2000), the IRS reviewed the ability of a leasing company or PEO to receive a refund of FICA and FUTA taxes paid with respect to workers who in the same year were both employed by the client company and the leasing company, and leased "back" to the former employer. Given the $7,000 cap on wages for FUTA purposes, it would not be unusual for the taxes collected to be doubled under such circumstances.

The IRS concluded that in general a separate wage base applied to each employer even if there was effective co-employment. However, if one company was the successor employer or served as the common paymaster for the other (an unusual circumstance), then there would be a single wage base. Also, if one employer remained the common law employer throughout the employment of a worker then a single wage base would apply.

In *Cencast Services, L.P. v. United States,*[94] the Court of Federal Claims upheld the IRS's position that an employer who controls the payments does not determine the wage base. Cencast provided workers to various employers in the entertainment industry. While it controlled the payment of wages, and thus was an employer within the meaning of Code section 3401(d)(1), the wage base was determined by Cencast's clients, which were the common law employers. The court reasoned that the parenthetical exclusion in Code section 3401(d)(1) of the definition of wages under subsection (a) meant that the common law, and not the control of payments, must be used to determine the wage base, which the court also found to be consistent with long-standing IRS administrative interpretation.[95]

§ 24.2.5(b)

Payroll Tax Penalties Imposed in Leasing Arrangements

A critical issue that any client company should consider when contracting with a leasing firm/PEO is whether it is adequately protected against potential payroll tax penalties resulting from the firm's failure to timely pay the payroll taxes owed on wages paid the leased workers. The IRS ruled in GCA 1999-32002 (Aug. 13, 1999) that if a client company contracts with a leasing firm/PEO and the firm does not qualify as the common law employer or the Code section 3401(d)(1) employer of the leased workers, the client company is solely liable for the employment tax penalties.

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[93] *See* Unemployment Insurance Tax Topic, U.S. Dep't of Lab., http://www.ows.doleta.gov/unemploy/uitaxtopic.asp.

[94] 62 Fed. Cl. 159 (2004).

[95] *See*, *e.g*., I.R.S. Tech. Adv. Mem. 99-18-056 (May 7, 1999) (holding that the wage base limit was set by clients even though taxpayer had control of payments under IRC section 3401).

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There also may be personal tax liability under Code section 6672, which creates liability for certain "responsible persons." In *Thosteson v. United States*,[96] an officer of an employee-leasing firm was held personally liable for approximately $1.3 million of unpaid employment taxes.

As a result of the ruling just mentioned, a recommended practice for client companies is to require a leasing firm/PEO to indemnify the client company against any payroll tax penalties imposed by the IRS with respect to wages paid for services performed for the client company.

§ 24.2.5(c)

Section 530 & Internal Revenue Code Section 3401(d)(1)

In Technical Advice Memorandum 84-10-012 (Nov. 29,1983), the IRS ruled that a person determined to be the employer of workers under Code section 3401(d)(1) can qualify for section 530 protection with respect to the workers at issue. For an example, if the firm refers the workers to perform services for a client company and the client company qualifies as the common law employer of the workers, the firm would avoid any employment tax liabilities with respect to the workers, even if it controls the payment of wages to the workers as contemplated by Code section 3401(d)(1). This general principle is subject to important exceptions and should not be relied upon by any firm without the advice and assistance of competent counsel.

§ 24.2.6

F. LABOR & EMPLOYMENT LAW ISSUES

§ 24.2.6(a)

Qualifying as a Common Law Employer

An employee leasing/PEO relationship involves a contractual allocation and sharing of employer responsibilities between the firm and its client company. The firm generally assumes responsibility and liability for human-resources issues and payroll-tax compliance, while the client company retains management and control of the day-to-day operation of its business.

In order to shift the underlying legal obligations with respect to leased workers that are imposed on the "employer," the parties must do more than contractually allocate responsibilities. The parties also must structure their respective relationships with the workers so that the party responsible for a certain employer obligation actually qualifies as the workers' employer under the governing statutes. As discussed below, doing this is not always easy and in some cases is not possible.

Historically, leasing firms have experienced difficulty qualifying as a common law employer of a leased worker. Usually, the difficulty derives from the practical problems that impede a firm's ability to exercise the requisite control over workers who perform services for a client company onsite. Many firms have attempted to overcome these problems by maintaining an on-site presence at a client company's premises. In addition, the firm, rather than the client company, generally maintains the right to hire, fire, and discipline workers.

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[96] 331 F.3d 1294 (11th Cir. 2003), *reh'g en banc denied*, 76 Fed. App'x 286 (11th Cir. 2003).

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Whether a leasing firm/PEO succeeds in establishing an employment relationship with a worker is determined by applying the tests outlined in this Chapter. The fact that a client company also is involved in a transaction does not affect such determinations, except for purposes of statutes to which the doctrine of "joint employment" applies.

§ 24.2.6(b)

Joint-Employer Status

Under certain labor and employment laws, the concept of *joint employment* makes it much easier for a firm to qualify as a worker's employer. The concept takes into account elements of control retained by both a firm and a client company in determining whether an employment relationship exists. Joint employment status for both a leasing company and the client company means that both may have the duty to withhold for federal taxes.[97] In Revenue Ruling 66-162, the IRS found sales clerks who received salaries from the department store and commissions from a concessionaire to be employees of both. Therefore, the IRS concluded that both had the obligation to withhold for federal taxes. However, there is no of joint employment for federal tax purposes, and so the IRS takes the position that whoever is in control of the payment of wages is the "employer" for employment tax purposes.[98]

The test for identifying joint employers in employee-leasing arrangements is similar to the test used in differentiating between employees and independent contractors.[99]

While the concept is helpful to firms that seek to qualify as a worker's employer, it may create potential pitfalls for client companies that enter into leasing arrangements precisely to avoid employer status. A determination that a leasing firm and its clients are joint employers of leased workers can destroy some of the anticipated benefits of the leasing arrangement. It can also subject clients to substantial liability for the leasing firms' acts or omissions, over which the client has little or no control. On the other hand, the leasing firm can incur liability for problems such as harassment by others in the workplace or plant safety problems over which it has little control. Accordingly, rights and responsibilities should be clearly established by contract from the outset.

Clients and leasing companies can avoid unexpected joint-employer liability in two ways: (1) by structuring the leasing arrangement in such a way that the client exercises little or no control over the leased employees;[100] or (2) by accepting the prospect of joint-employer status and including in the leasing agreement the appropriate indemnification provisions that allocate liability in accordance with the parties' expectations. In either case, an indemnification agreement is a prudent precaution.

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[97] Rev. Rul. 66-162.

[98] Field Service Advice Mem. 200023006 (Feb. 2, 2000).

[99] *See Reynolds v. CSX Transp.*, 115 F.3d 860, 869 n.9 (11th Cir. 1997), *vacated & remanded by* 524 U.S. 947 (1998); *Amarnare v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 611 F. Supp. 344 (S.D.N.Y. 1984), *aff'd*, 770 F.2d 157 (2d Cir. 1985); *Zinn v. McKune*, 143 F.3d 1353, 1361 (10th Cir. 1998); *Catani v. Chiodi*, 2001 U.S. Dist. LEXIS 17023 (D. Minn. Aug. 13, 2001).

[100] *See Barfield v. N.Y. City Health & Hosps. Corp.*, 537 F.3d 132, 138 (2d Cir. 2008) (finding joint employer status when the plaintiff performed work on the hospital's premises, using the hospital's equipment and the work was integral to the hospital's operation).

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§ 24.2.6(c)

Retirement & Health Benefits

With few exceptions, employee benefit plans must cover only employees of the sponsoring employer. Workers who are independent contractors with respect to the sponsoring employer generally are ineligible to participate in such plans. Ineligible workers include:

- self-employed independent contractors who contract with the sponsoring employer to provide services for the sponsoring employer;
- workers who contract with the sponsoring employer (*i.e.*, a leasing firm) to provide services for a client company and qualify as an employee of the client company but not the firm; and
- workers who contract with a leasing firm to provide services for the sponsoring employer (*i.e.*, the client company) and qualify as an employee of the leasing firm but not the client company.

The consequences of mistakenly allowing a non-employee (*i.e.*, independent contractor) to participate in an employee benefit plan can be draconian. For example, with respect to a qualified retirement plan, the consequences may include:

- immediate liability to plan participants (*i.e.*, employees) for income taxes on the amount of their vested benefits under the plan;
- liability to plan participants for employment taxes on amounts received;
- potential liability for penalties and interest; and
- a breach of fiduciary duty under ERISA, which requires that all plan assets be held for the exclusive purpose of benefiting employees and their beneficiaries.

Additionally, unless firms qualify as a common law employer of workers participating in a health benefit plan maintained by the firm, the plan could be deemed a multiple employer welfare arrangement (MEWA). Many states subject MEWAs to significant regulation, particularly if the MEWA is self-insured. These regulations are similar to, but generally less financially demanding than, state insurance regulations. In addition, a MEWA that is not self-insured but provides coverage through health insurance could be treated as engaged in the unlicensed sale of insurance.

To determine independent contractor status for ERISA purposes, courts apply a common law agency test:[101]

- the right to control the manner and means by which the project is accomplished;
- the skill required;
- the source of the instrumentalities and tools;
- the location of the work;
- the duration of the relationship between the parties;

[101] *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323-24 (1992) (citing *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 751-52 (1989)).

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- whether the hiring party has the right to assign additional projects to the hired party;
- the extent of the hired party's discretion over when and how long to work;
- the method of payment;
- the hired party's role in hiring and paying assistants;
- whether the work is part of the regular business of the hiring party;
- whether the hiring party is in business;
- the provision of employee benefits; and
- the tax treatment of the hired party.

§ 24.2.6(c)(i)

Contingent Workers' Claims for Benefits

Businesses should cautiously draft all benefit plans to specifically exclude all contingent workers that they do not intend to cover under the plan. In doing so, the company should first consult with legal counsel to ensure that it is permissible to exclude certain groups of employees from any selected benefit plan. They also should ensure that no independent contractors are allowed to participate in the benefit plans that they sponsor and maintain. The court in *Wolf v. Coca-Cola Co.*[102] held that an eligibility criterion that excludes "individuals who perform services for the company under an agreement with a leasing organization" was sufficient for purposes of excluding leased workers from an ERISA plan.

One particularly costly example of the repercussions of worker misclassification was the landmark case *Vizcaino v. Microsoft*.[103] In October 1996, the U.S. Court of Appeals for the Ninth Circuit held that Microsoft Corporation had improperly classified certain software testers and technical-manual writers as independent contractors. The court found that these individuals qualified as employees of Microsoft and, as such, should have been allowed to participate in the company's stock-purchase plan. The court determined that these contract employees had the right to participate despite the fact that the employees had signed agreements acknowledging responsibility for paying their own federal taxes and benefits.[104]

In December 2000, Microsoft Corporation settled the class-action lawsuit for $96.9 million. The settlement went into a settlement fund to compensate workers that provided services as independent contractors or through temporary staffing agencies. In addition, in April 2001, the court awarded the settlement fund plaintiff's counsel costs and attorneys' fees of $27 million.[105]

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[102] 200 F.3d 1337, 1342 (11th Cir. 2000). See also *Law v. Northwest Natural Gas Co.*, 2007 U.S. Dist. LEXIS 32973 (D. Or. May 2, 2007), where the court held that it did not matter if the workers were considered common law employees since they were ineligible for benefits under the language of the employer's pension plan.

[103] 97 F.3d 1187 (9th Cir. 1996), *en banc review granted*, 105 F.3d 1334 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998).

[104] *Id.*

[105] *Vizcaino v. Microsoft Corp*., 142 F. Supp. 2d 1299 (W.D. Wash. 2001); *see also Clark v. E.I. DuPont De Nemours & Co*., 105 F.3d 646 (4th Cir. 1997), *cert. denied*, 520 U.S. 1259 (1997).

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Another problematic decision was *Herman v. Time Warner, Inc.*,[106] where a New York district court held that the U.S. Department of Labor (DOL) can sue plan fiduciaries for breach of fiduciary duty for denying workers access to ERISA-covered benefit plans where the workers were misclassified as contingent workers. The decision was an example of how large employers have few practical means to ensure that workers at all of its locations are being classified properly. In 2000, the DOL and Time Warner entered into a $5.5 million settlement of this case. The settlement provided retirement benefits and non-reimbursed medical expenses to certain temporary employees and misclassified independent contractors who provided services for the company between 1992 and 1997. On the same day, the same New York district court affirmed a series of decisions by the administrative committee that certain independent contractors were properly denied benefits.[107] The court found that the subject workers were either ineligible because they were independent contractors and/or if employees, they were properly excluded under the plan's eligibility criteria.

However, the U.S. District Court for the Middle District of Louisiana offers hope for employers who enter into independent contractor relationships at the behest of their workers. In *Kiper v. Novartis Crop Protection, Inc.*,[108] the court held that workers were equitably estopped from alleging entitlement to benefits where they personally solicited the company about entering into an independent contractor relationship and negotiated for increased wages in lieu of benefits. This is not to suggest that equitable estoppel is available as a defense in all situations where higher pay is offered in lieu of benefits. Key to the court's decision in *Kiper*, was the fact that it was the individuals who sought the independent contractor status and higher wages, and the company did not unilaterally impose these conditions upon them. In the latter situation, a court would be far more reluctant to apply the equitable doctrine of estoppel to bar recovery to a worker who was misclassified.

§ 24.2.6(c)(ii)

ERISA Section 510

Employers should be aware that ERISA section 510 prohibits the termination of a worker for the purpose of interfering with the workers' attainment of ERISA-covered benefits.[109] This language has been interpreted to only protect against the disruption of employment privileges to prevent their vesting, to prevent their exercise or in retaliation for testimony offered in an ERISA proceeding.[110] Accordingly, a persuasive argument can, and has been made that ERISA section 510 does not regulate hiring or rehiring decisions. In the case of *Becker v. Mack Truck*,[111] the court found that ERISA section 510 does not apply in rehiring decisions, even where as in *Becker* the employer blatantly refuses to rehire employees solely because the costs of their benefits will be higher than that of new employees. The court found that ERISA section 510 "simply does not require that employers blind themselves to the effect of future pension liability when making hiring decisions."[112] Relying on the Third Circuit decision, the District Court for the Southern District of New York held that an employee who

[106] 56 F. Supp. 2d 411 (S.D.N.Y. 1999).

[107] *Administrative Comm. of Time Warner, Inc. Benefit Plans v. Biscardi*, 2000 U.S. Dist. LEXIS 6238 (S.D.N.Y. May 5, 2000).

[108] 209 F. Supp. 2d 628 (M. D. La. 2002).

[109] 29 U.S.C. § 1140 (2008).

[110] *See Sandberg v. KPMG Peat Marwick*, 111 F.3d 331 (2d Cir. 1997).

[111] 281 F.3d 372 (3d Cir. 2002).

[112] *Id.* at 383.

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was "intentionally" misclassified when hired to avoid the payment of benefits, could not state a cause of action under ERISA section 510.[113]

While the coverage of ERISA section 510 traditionally has been acknowledged to cover pension benefits, a U.S. Supreme Court decision suggests that coverage might also extend to welfare benefits such as health coverage.[114]

Section 510 is significant to leasing arrangements because a client company could be vulnerable to a claim by its workers if the benefit programs offered by the firm are less generous than the benefits the workers would receive through the client company. In order to minimize the risk of liability under ERISA section 510, client companies should carefully document the business reasons for implementing a leasing transaction and be mindful of the disparities in benefits provided by it and the leasing firm.

§ 24.2.6(c)(iii)

Internal Revenue Code Section 414(n) Leased Employees

Another dimension to the employee benefit implications of employee leasing is provided by Code section 414(n), which states that leased employees, for purposes of certain employee benefit provisions, shall be treated as employees of the recipient organization (*i.e.*, the client of an employee leasing firm).

Code section 414(n) defines a *leased employee* as any person who is not an employee of the recipient that performs services for the recipient if the services are provided pursuant to an agreement between the recipient and a leasing organization, such services are performed on a substantially full-time basis for a period of at least one year, and are performed under the primary direction or control of the recipient.[115] This definition includes an oral agreement for such services. An individual has performed services on a substantially full-time basis if the individual has performed: (1) at least 1500 hours of service for the recipient during any consecutive 12 month period; or (2) a number of hours at least equal to 75% of the time customarily performed by an employee of the recipient in the particular position.

According to the relevant legislative history, factors considered in determining whether services are performed under the primary direction and control of the recipient include whether:

- the individual is required to comply with instructions of the service recipient about when, where, and how he or she is to perform the services;
- the services must be performed by a particular person;
- the individual is subject to the supervision of the recipient; and
- the individual must perform services in the order or sequence set by the recipient.

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[113] *Williams v. American Int'l Group, Inc.*, 2002 U.S. Dist. LEXIS 17886 (S.D.N.Y Sept. 23, 2002). Though precluded from a cause of action under ERISA section 510, consistent with the Ninth Circuit's opinion in *Vizcaino*, the Third Circuit noted that if the employee had adequately exhausted her administrative remedies, which she did not in *Williams*, she may have been able to sustain a cause of action under ERISA section 502.

[114] *Inter-Modal Rail Employees Ass'n v. Atchison*, *Topeka & Santa Fe Ry.*, 520 U.S. 510 (1997), *remanded by* 117 F.3d 1136 (9th Cir. 1997).

[115] I.R.C § 414(n)(2) (2008).

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A plan maintained by a client may exclude all leased employees under Code section 414(n), subject to certain requirements.[116] All leased employees are treated as "employees" for purposes of applying certain tax requirements. One such requirement that applies only to qualified retirement plans is that the plan benefits at least 70% of the sponsoring employer's non-highly compensated employees.[117] A business using leased employees should keep these rules in mind when excluding workers who qualify as "leased employees" so that favorable tax treatment of the plan is preserved.

Companies should not confuse the type of leased employee defined in Code section 414(n) with the more colloquial term, which refers to workers engaged by a client company through a firm. For example, one case involved a qualified retirement plan that excluded the participation of certain workers by referencing them as "leased employees" under Code section 414(n).[118] The court held that it was an insufficient basis for exclusion.

While the court in *Burrey* ultimately held that the workers at issue were not eligible to participate in the plan, the decision was obtained only after protracted litigation and was based upon a determination that the workers did not qualify as common law employees of the sponsoring employer. It is fairly common, however, to see exclusions in plans refer to section 414(n) even though employers may be excluding a far broader class of individuals in actual practice. Accordingly, a far superior plan provision for excluding such workers is one that excludes all workers who perform services for the sponsoring employer pursuant to a contract with and who are paid by a third party.

§ 24.2.6(d)

Wage & Hour Considerations

The Fair Labor Standards Act (FLSA) was enacted to protect employees from substandard wages and excessive hours.[119] FLSA minimum wage, overtime, equal pay, and child labor protections apply to employees who are engaged in interstate commerce, in the production of goods for commerce, or employed by an "*enterprise*" engaged in interstate commerce.[120] Employees of private sector employers, state and local government, and most federal agencies are covered.[121]

The protections of the FLSA apply only to employees, but the FLSA defines the term broadly.[122] An *employee* is defined as any individual employed by an employer, but the FLSA defines the verb "employ" expansively to mean suffer or permit to work.[123]

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[116] *Bronk v. Mountain States Tel. & Tel.*, 140 F.3d 1335 (10th Cir. 1998).

[117] I.R.C. § 410(b) (2008).

[118] *Burrey v. Pacific Gas & Elec. Co.*, 159 F.3d 388 (9th Cir. 1998).

[119] 29 U.S.C. §§ 201 *et seq.* (2008).

[120] *Id.* §§ 206, 207, 212. The Second Circuit Court of Appeals recently held that "'enterprise' does not extend to a private, non-profit, independent contractor associated by regulation and contract with a public agency, [and thus] not obligated to pay overtime." *Jacobs v. N.Y. Foundling Hosp.*, 577 F.3d 93 (2d Cir. 2009) (discussing section 203(r)(1) and interpreting section 203(r)(2)(C)).

[121] *Id.* § 203.

[122] *Id.* § 203(e), (g).

[123] *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947); *cf. Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992). In *Darden*, the court distinguished the FLSA's expansive definition of *employee* from the definition provided in ERISA, which is *any individual employed by an employer.* 29 U.S.C. § 1002(6) (2008). The court in *Darden* articulated the general rule that determination of employee

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The U.S. Supreme Court held in *Rutherford Food Corp. v. McComb* that the traditional common law criteria were not broad enough to determine whether a worker was an independent contractor or a protected employee for FLSA purposes. Rather, the court held that a more appropriate test would include an examination of the underlying "economic realities" of the work relationship.[124]

Nonetheless, a primary consideration in determining whether a worker's status for purposes of the FLSA is whether the engaging entity has the right to control how the work is to be performed by the worker.

Thus, while the "economic realities" analysis is what distinguishes the FLSA test from a common law-based test (such as the test used for federal tax purposes), even the FLSA test does not totally disregard the common law "control" factor.

In *Rutherford Food Corp.*, the Supreme Court ruled that slaughterhouse meat boners were employees, based upon the following facts:

- the job duties were interchangeable between workers;
- the company supplied the equipment and premises for the work;
- the company was the workers' single source of work;
- the company closely supervised the workers' performance; and
- although the workers did profit from their efficiency, they did not enjoy the type of profit generally associated with entrepreneurship.[125]

The Supreme Court reached this conclusion after evaluating the circumstances of the whole activity; no single factor was considered determinative.

The DOL, which is the government agency that enforces the FLSA, interprets the Supreme Court's economic realities test to mean that the primary consideration is whether the engaging entity controls or has the right to control the work to be done by the worker to the extent of prescribing how the work shall be performed. The DOL recognizes that a determination of a worker's status cannot be based on isolated factors or a single characteristic but, as stated in *Rutherford Food Corp.*, must take into account "the circumstances of the whole activity."[126]

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status under federal statutes should employ the common law test unless the statute itself defines employee more expansively so as to cover some parties who might not qualify as such under a strict application of traditional agency law principles. *Darden*, 503 U.S. at 323-24. The Supreme Court noted that the FLSA is such a statute.

[124] *Rutherford Food Corp.*, 331 U.S. at 727. This test is important because "the fact that the parties . . . may have entered into a relationship which appeared on paper to be that between a business and an independent contractor is not dispositive of the issue of whether [the] [p]laintiff was, in reality, an employee as opposed to an independent contractor for FLSA purposes." *Padjuran v. Aventura*, 500 F. Supp. 2d 1359, 1362 (S.D. Fla. 2007); *see also Estrada v. Fedex Ground Package Sys., Inc.*, 154 Cal. App. 4th 1, 10-11 (2007) (observing that "the parties' label is not dispositive and will be ignored if their actual conduct establishes a different relationship") (settled in December 2008 for approximately $27 million).

[125] *Rutherford Food Corp.*, 331 U.S. at 730.

[126] *See*, *e.g.*, U.S. DEP'T OF LABOR, FIELD OPERATIONS HANDBOOK ch. 10, § 10b05-10b09 (1993), *available at* http://www.dol.gov/esa/whd/FOH/index.htm [hereinafter "FOH"].

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To determine whether the right to control exists, the DOL accords emphasis to the following factors: (1) the extent to which the services in question are an integral part of the employer's business; (2) the amount of the contractor's investment in facilities and equipment; (3) the contractor's opportunities for profit and loss; and (4) the amount of initiative, judgment, or foresight in open-market competition with others required for the success of the claimed independent enterprise.[127]

Additional factors the DOL considers include whether:

- the contract gives any right to the engaging party to detail how the work is to be performed;
- the engaging party has control over the business of the contractor;
- the contract is for an indefinite or relatively long period;
- the engaging party may discharge the contractor's employees;
- the engaging party has the right to cancel the contract at will; and
- the purported independent contractor is performing work that is the same or similar to that performed by the engaging party's employees.[128]

The DOL regards certain factors as immaterial to the determination of employee status, including whether the worker has a license from a state or local government; the measurement, method, or designation of compensation, the fact that no compensation is paid and the worker must rely entirely on tips, the place where the work is performed, and the absence of a formal employment agreement.[129]

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[127] FOH § 10b05.

[128] FOH § 10b06; *see also Henderson v. Inter-Chem Coal Co*., *Inc.*, 41 F.3d 567 (10th Cir. 1994) (reversing summary judgment for the employer because genuine issue of material fact existed as to whether mechanic was an employee or independent contractor); *Carrell v. Sunland Const*., *Inc.*, 998 F.2d 330, 334 (5th Cir. 1993) (welders were independent contractors and not employees); *Martin v. Selker Bros., Inc.*, 949 F.2d 1286, 1293-96 (3d Cir. 1991) (commissioned service station operators were employees); *Brock v. Superior Care*, *Inc.*, 840 F.2d 1054, 1058-59 (2d Cir. 1988) (nurses dispatched by home health care service were employees); *Secretary of Labor*, *U.S. Dep't of Labor v. Lauritzen*, 835 F.2d 1529, 1534-35 (7th Cir. 1987) (migrant farm workers economically dependent on the farms they worked for were employees); *Donovan v. DialAmerica Mktg*., *Inc.*, 757 F.2d 1376, 1382 (3d Cir. 1985) (home researchers of telephone marketing firm were employees, but distributors who recruited and picked up and delivered researchers' work product were independent contractors); *Donovan v. Brandel*, 736 F.2d 1114, 1117-20 (6th Cir. 1984), *reh'g denied*, 760 F.2d 126 (1985) (migrant farm workers with special harvesting skills were independent contractors and not employees); *Doty v. Elias*, 733 F.2d 720, 723 (10th Cir. 1984) (waiters and waitresses were employees); *Real v. Driscoll Strawberry Assocs*., *Inc.*, 603 F.2d 748, 754 (9th Cir. 1979) (strawberry growers may be employees); *Usery v. Pilgrim Equip. Co., Inc.*, 527 F.2d 1308, 1311-15 (5th Cir. 1976), *cert. denied*, 429 U.S. 826 (1976) (laundry workers were employees); *Baker v. Barnard Const. Co.*, 860 F. Supp. 766 (D.N.M. 1994) (rig welders were granted overtime compensation because they were found to be employees under the FLSA); *Martin v. Albrecht*, 802 F. Supp. 1311, 1313-14 (W.D. Pa. 1992) (seamstresses who worked at home were employees).

[129] FOH § 10b07(c).

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Another way in which a company can be deemed to be responsible for complying with the FLSA with respect to a worker is by application of the "joint employer" doctrine.[130]

§ 24.2.6(e)

Workers' Compensation

In many states, a company can provide coverage for contingent workers by covering them under the company's own workers' compensation policy, but this method of coverage can be very expensive. Years ago, companies used employee leasing arrangements as a means for reducing their workers' compensation premiums. Many state legislatures reacted to those efforts by enacting measures designed to curtail the ability of leasing firms to allow client companies to obtain lower premiums. Accordingly, leasing companies and their client companies should be on the lookout for special workers' compensation rules applicable to leased employees.

Clients should also be aware of potentially restrictive classification procedures with respect to leased employees for workers' compensation purposes. Employees are commonly classified for workers' compensation purposes based upon the likelihood of injury in their employer's line of business. Thus, a client in a dangerous line of business might expect to obtain reduced premiums by entering into a leasing transaction that mixes its workers together with workers of other companies who presumably are within lower-risk classifications. That gambit no longer works in most states. Today, most states trace workers' compensation premiums back to the client company for which the workers perform services.

Finally, clients seeking to avoid employer responsibilities for workers' compensation premiums and benefits by using leased employees should be aware that by doing so they also risk losing the benefits of the "exclusive" remedy of workers' compensation systems. In most states, the workers' compensation remedy is the exclusive form of relief available against the employer for workplace injuries. Companies seeking to avoid workers' compensation liabilities also risk losing this valuable defense. Particularly if the client company owns and maintains the workplace, there can be a very real potential for substantial liability if a leased employee is injured.

All states, except Texas, require employers to maintain workers' compensation insurance for their employees. Such a requirement gives rise to questions as to which entity — the client company or the firm — must obtain this insurance. State law controls the answer to this question. In New York, for example, the client company must obtain workers' compensation insurance covering all its workers, regardless of whether they are its employees. In addition, a leasing firm/PEO must either obtain insurance covering all workers for whom the firm is considered a common law employer or else obtain an endorsement on the client company's policy.

In Massachusetts, the opposite is true (*i.e.*, the firm must obtain insurance naming the client company as an insured).[131] In most states where leasing firms are regulated by statute, the

[130] *See*, *e.g.*, *Baystate Alternative Staffing v. Herman*, 163 F.3d. 668 (1st Cir. 1998) (holding a leasing firm and client company to be joint employers with respect to leased workers for purposes of the FLSA). *But see Jeanneret v. Aron's East Coast Towing*, *Inc*., 2002 U.S. Dist. LEXIS 12200 (S.D. Fla. Jan. 29, 2002) (holding a leasing firm and client company not to be joint employers for purposes of the FLSA, despite the written arrangement between the parties because the client company in practice exercised exclusive control over the workers).

[131] 211 MASS. CODE REGS. 111.04 (2007).

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PEO may obtain the workers' compensation insurance but must maintain segregated accounts for each client (*e.g*., Oregon, Ohio, North Carolina, Tennessee, and Washington). In Rhode Island and Georgia, only the PEO needs to provide insurance but the insurance must cover both the PEO and its clients.[132]

In order to avoid any penalties or liability for mistakenly failing to obtain workers' compensation insurance, legal counsel should be consulted to determine the workers' compensation requirements under the law of the particular state in question.[133]

§ 24.2.6(f)

Employee Safety: Fed-OSH Act

The federal Occupational Safety and Health Act ("Fed-OSH Act") defines employee as an employee of an employer who is employed in a business that affects commerce.[134] An independent contractor may be classified as an employee based upon the following factors:

- Whom do the workers consider their employer?
- Who pays the workers' wages?
- Who has responsibility to control the workers?
- Does the alleged employer have the power to control the workers?
- Does the alleged employer have the power to fire or hire the workers or modify the workers' employment conditions?
- Does the workers' ability to increase their income depend on efficiency rather than initiative, judgment, and foresight?
- How are the workers' wages established?[135]

In addition to the application of the statute to contingent workers described above, a body of case law exists to identify the proper employer for Fed-OSH Act purposes in the context of a loaned employee. This context may prove analogous to the leased-employee situation.

In these cases, loaning organizations seek to disclaim liability under the Fed-OSH Act by shifting responsibility to the borrowing companies through different contractual arrangements. The Occupational Safety and Health Review Commission (OSHRC) has stated that even where a borrowing company has agreed to accept responsibility, "an employer remains accountable for the health and safety of its employees, wherever they work, and cannot divest itself of its obligations under the Act by contracting its responsibility to another employer."[136] It is therefore unlikely that a leasing agreement can free a client from ultimate

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[132] R.I. GEN. LAWS § 28292; GA. CODE ANN. § 34911(c).

[133] In 2009 alone, several states passed legislation aimed at punishing employers who misclassify workers, either "improperly" and "knowingly," as independent contractors to avoid paying workers' compensation premiums and unemployment insurance. *See, e.g.*, Misclassification of Employees as Independent Contractors Act, H.B. 09-1310 (Colo. 2009); Workplace Fraud Act, H.B. 230, 145th Gen. Assem. (Del. 2009).

[134] 29 U.S.C. § 652(6) (2008).

[135] *Secretary v. Griffin & Brand of McAllen, Inc.*, 6 O.S.H. Cas. (BNA) 1702 (1978).

[136] *Secretary v. Acchione & Canuso, Inc.*, 7 O.S.H. Cas. (BNA) 2128 (1980).

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Fed-OSH Act responsibility for leased employees if the client qualifies as the employer of affected workers for purposes of the Fed-OSH Act statute.

§ 24.2.6(g)

Labor Relations & Union Obligations

The National Labor Relations Act (NLRA) protects the rights of employees to organize, to choose their own collective bargaining representatives, and to engage in concerted activities for the purpose of collective bargaining, mutual aid or protection, or to refrain from such activities.[137]

Independent contractors are specifically excluded from coverage under the NLRA. To distinguish employees from independent contractors for purposes of the NLRA, the National Labor Relations Board (NLRB) employs a common law agency test, frequently emphasizing the right-to-control element.

The NLRB administers and enforces the NLRA.[138] Thus, the NLRB may be required to determine whether a worker is a protected employee or an excluded independent contractor in representation proceedings. The NLRB has described the right-to-control test as follows:

> In determining the status of persons alleged to be independent contractors, the Board has consistently held that the Act required application of the right of control test. Where the one for whom the services are performed retains the right to control the manner and means by which the result is to be accomplished, the relationship is one of employment; while, on the other hand, where control is reserved only as to the result sought, the result is that of an independent contractor. The resolution of this question depends on the facts of each case, and no one factor is determinative.[139]

The NLRA decisions, however, on whether the right-to-control test or the entrepreneurial opportunity test should be used remained unclear. In *Dial-A Mattress Operating Corp.*,[140] and *Roadway Package System, Inc.*,[141] the Board determined that it lacked the authority to depart from the common law test as the legal determinant of a worker's status under the NLRA. In addition, the Board rejected an interpretation of the test that would have accorded increased weight to the right-of-control factors, holding instead that the NLRA required a careful examination of *all* factors of the common law test.[142]

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[137] 29 U.S.C. § 157 (2008).

[138] *Id.* §§ 153, 159, 160.

[139] *News Syndicate Co*., 164 N.L.R.B. 422, 423-24 (1967).

[140] 326 N.L.R.B. No. 75 (1998).

[141] 326 N.L.R.B. No. 72 (1998).

[142] The NLRB has dealt with the issue of independent contractor status in a variety of business settings. *See*, *e.g.*, *Aurora Packing Co. v. NLRB*, 904 F.2d 73 (D.C. Cir. 1990) (Board order denied enforcement; kosher slaughterers were independent contractors); *Collegiate Basketball Officials Ass'n, Inc.*, 836 F.2d 143 (3d Cir. 1987) (basketball officials who refereed games were independent contractors); *Newspaper Drivers & Handlers Local Union No. 372 v. NLRB*, 682 F.2d 116 (6th Cir. 1982) (newspaper carriers were employees); *Glens Falls Newspapers*, *Inc.*, 303 N.L.R.B. 614 (1991) (newspaper route drivers were independent contractors); *Asheville Citizen-Times Publ'g Co.*, 298 N.L.R.B. 949 (1990) (home-delivery, single-issue, and combination home-delivery and single-issue carriers of newspaper were independent contractors); *Central Transp*., *Inc.*, 299 N.L.R.B.

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However, the U.S. Court of Appeals for the District of Columbia upheld a classification decision of the NLRB wherein the Board shifted the focus from the traditional right-to-control test to an alternative test that looked primarily at the worker's "entrepreneurial opportunity for gain or loss." Both the Board and the court agreed that this test "better captures the distinction between an employee and an independent contractor."[143]

The Board's decision in *Corporate Express* created confusion for employers seeking to classify employees. An administrative decision thereafter clarified the test for determining a worker's status for purposes of the NLRA.[144] *Allstate Insurance Co.* held that enhanced weight should be given to the factors of entrepreneurial opportunity and proprietary rights in determining whether one is an employee or an independent contractor for purposes of the NLRA. The issue in *Allstate* was whether a union could represent certain exclusive agents engaged by Allstate to solicit insurance products. The court held the exclusive agents were ineligible because they were independent contractors. In doing so, the court added weight to certain factors not related to "control," such as: (1) entrepreneurial opportunity for gain or loss; (2) proprietary interest in the individual's business; (3) ability to control the hiring of employees; (4) obligation to work each day; and (5) right to pursue outside business.[145]

Allstate gives clear guidance for how service-based-firms can operate as independent contractors without worrying about union organizing attempts. This continues a trend where the NLRA has shifted its emphasis towards factors other than control over performance to those such as entrepreneurial opportunity and proprietary rights.

In another significant decision, the NLRB let stand a decision by its Fourth Region that physicians under contract with an HMO were not covered by the NLRA because they qualified as independent contractors with respect to the HMO.[146] The practical effect of the decision was to deny the physicians the right to union representation in their dealings with the HMO. By contrast, the Board held that medical interns qualified as employees for purposes of the NLRA.[147]

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5 (1990) (owner-operators were independent contractors); *F & R Meat Co.*, 296 N.L.R.B. 759 (1989) (husband and wife who cleaned the plant were independent contractors); *DIC Animation City*, *Inc.*, 295 N.L.R.B. 989 (1989) (developers and writers for animated scripts were independent contractors); *Package Sys.*, *Inc.*, 288 N.L.R.B. 196 (1988) (lessee-drivers were employees); *Big East Conference*, 282 N.L.R.B. 335 (1986), *aff'd sub nom.*, 836 F.2d 143 (3d Cir. 1987); *Roadway Don Bass Trucking*, *Inc.*, 275 N.L.R.B. 1172 n.9 (1985) (listing numerous cases in which the right-to-control test is applied to owner-operators and taxi drivers to determine independent contractor status); *ARA Leisure Serv., Inc.*, 272 N.L.R.B. 1300 (1984), *review denied, enforced,* 782 F.2d 456 (4th Cir. 1986) (novelty vendors under a concession lease between the company and a sports arena were employees); *Oakland Press Co.*, 249 N.L.R.B. 1081 (1980), *aff'd in part and remanded in part sub nom.,* 266 N.L.R.B. 107 (1983).

[143] *Corporate Express Delivery Sys. v. NLRB*, 292 F.3d 777, 780 (D.C. Cir. 2002).

[144] *Allstate Ins. Co.*, Case 13-RC-20827 (Region 13 Dec. 2, 2002).

[145] *Id.*

[146] *AmeriHealth Inc.* 329 N.L.R.B. No. 76 (1999); *see also New York Univ.*, 332 N.L.R.B. 111 (2000) (finding graduate assistants to be statutory employees).

[147] *Boston Med. Ctr. & House Officers' Ass'n*, 330 N.L.R.B. No. 30 (1999).

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The factors weighed by the NLRB in determining employee or independent contractor status include the common law factors set forth in the Restatement (Second) of Agency section 220(2) (1958).[148]

§ 24.2.6(g)(i)

Government-Mandated Control Not Considered

The NLRB and the reviewing courts have taken the position that control by the engaging firm that is required by law or governmental regulation should not be considered in assessing the engaging firm's right to control the manner and means by which the worker accomplishes the result. "Enforcement of laws or governmental regulations . . . is not considered control over the 'manner and means' by which results are accomplished, because such enforcement is, in reality, supervision by the government, not by the 'employer.'"[149]

§ 24.2.6(g)(ii)

Joint Employer Status

Joint-employer status under the NLRA will be found where, despite an absence of common ownership, one entity effectively and actively participates in the control of labor relations and the working conditions of employees of a second entity.[150] The analysis of joint-employer status for employee-leasing arrangements under the NLRA begins with the language of the lease. If the client reserves the right to control the leased employees, it will be a joint employer and subject to NLRA employer status. If, on the other hand, the client explicitly cedes all authority over the leased employees to the leasing organization, the NLRB will examine the day-to-day workings of the relationship to determine if joint-employer status may still exist.

Under the NLRA, "[t]he joint employer concept recognizes that two or more business entities are in fact separate but that they share or codetermine those matters governing the essential terms and conditions of employment."[151] Among the factors considered in making this determination are: (1) the contractual language; (2) whether the client had authority to hire, discharge, or pay the wages of the employees; (3) who supervised the employees; (4) whether the supervisors consulted with the client; (5) who was responsible for the preparation of the payroll and appropriate deductions; (6) who prepared the tax returns with respect to the deductions; (7) who established holidays; and (8) who provided uniforms.[152] Joint-employer analysis under the NLRA is extremely fact specific, and appropriate investigation of the leasing organization and indemnity assurances are recommended.

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[148] *Merchants Home Delivery Serv., Inc. v. NLRB*, 580 F.2d 966, 973 (9th Cir. 1978); *Gary Enters., Inc.*, 300 N.L.R.B. 1111, 1112 (1990), *enforced sub nom. NLRB v. Gary Enters.*, 958 F.2d 368 (4th Cir. 1992); *Air Transit, Inc.*, 271 N.L.R.B. 1108, 1110-11 (1984).

[149] *Cardinal McCloskey Children's & Family Servs.*, 298 N.L.R.B. 434, 435 (1990) (finding that daycare providers were independent contractors; lack of entrepreneurial opportunity was due to pervasive control by the city, not engaging agency); *Democratic Union Org. Comm. v. NLRB*, 603 F.2d 862, 875 (D.C. Cir. 1978) (analysis adopted by the NLRB in *Air Transit, Inc.*, 271 N.L.R.B. 1108 (1984)).

[150] *See, e.g., NLRB v. Browning-Ferris Indus., Inc.*, 691 F.2d 1117 (3d Cir. 1982).

[151] *H&W Motor Express, Inc.*, 271 N.L.R.B. 466, 467 (1984).

[152] *Greenhoot, Inc.*, 205 N.L.R.B. 250 (1973).

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§ 24.2.6(h)

Layoffs & Plant Closures: WARN

Independent contractors, if properly classified, are separate employers for purposes of the Worker Adjustment and Retraining Notification Act (WARN), which requires advance notice to employees of impending mass layoffs and plant closures. Thus, independent contractors and their employees are not counted towards the threshold number of employees for a company when determining whether notice is required. Furthermore, independent contractors are not entitled to receive notice from the hiring entity, even if the threshold is met. According to the regulations promulgated under WARN, factors considered to distinguish independent contractors from employees for WARN purposes include *de facto* exercise of control, unity of personnel policies emanating from a common source, and the dependency of operations. The real question is whether the independent contractor is sufficiently independent of the hiring entity.[153]

Leased employees (such as temporary workers obtained from a temporary agency that acts as the primary employer) present special issues under WARN. It appears that the company that uses the services of a leased employee, but does not pay the leased employee, is not required to give that worker notice of a plant closing under WARN. The appropriate regulations state in the definition of affected employees: "Consultant or contract employees who have a separate employment relationship with another employer and are paid by that other employer . . . are not 'affected employees' of the business to which they are assigned."[154] Thus, assuming that the leasing organization is responsible for payroll, it, not the company engaging the workers' services, is likely responsible for compliance with WARN.

Employers using the services of leased employees should nevertheless be wary of joint-employer issues under WARN. This theory has been applied under a number of other statutes and will inevitably be addressed under WARN. Because the employer using the leased workers' services will have advanced notice of when a plant closing or layoff is scheduled to occur, that employer may well be charged with responsibility for giving leased workers notice on a joint-employment theory, or at least giving the leasing company sufficient notice to allow it to give the workers timely notice, despite the regulation noted above. Users of leased employees should also be aware of the potential need to count leased employees when determining whether the company is covered by WARN, or when determining whether a job action has affected enough employees that WARN is triggered. Again, a joint employment theory may require that the leased employees be considered for these purposes.

§ 24.2.6(i)

Employment Discrimination

After several years of uncertainty of whether courts should apply the common law agency or "hybrid" test to determine whether a worker is an employee under Title VII of the Civil

[153] 20 C.F.R. § 639.3(a)(2) (2008); *Bradley v. Sequoyah Fuels Corp.*, 847 F. Supp. 863, 868 (E.D. Okla. 1994).

[154] 20 C.F.R. § 639.3(e) (2008).

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Rights Act of 1964 ("Title VII"), the Supreme Court made clear that all federal employment laws are to be interpreted using the common law agency test.[155]

§ 24.2.6(i)(i)

Always Engage Independent Contractors by Written Agreements

The importance of following the practice of always engaging independent contractors by a written agreement was underscored by the decision in *Adcock v. Chrysler Corp*.[156] In that case, the court rejected a perspective employee's Title VII claim based on its determination that the individual would have been engaged as an independent contractor. In reaching its decision, the court relied on a draft of the agreement that the company used when engaging others for a similar position. *Taylor v. ADS, Inc.*,[157] also discusses the structuring of a contract that deflected a Title VII claim.

§ 24.2.6(i)(ii)

Employee Leasing Arrangements

While written agreements are praised in the discussion above concerning independent contractors, they offer no absolute panacea, especially in leasing arrangements. In *Atchley v. Nordam Group, Inc.*,[158] a client company was held singularly liable for employment law violations with respect to leased employees, even though its agreement with the leasing firm expressly designated the leasing firm as the workers' employer for all purposes and the leasing firm indemnified the client company against the negligent acts of the leasing firm. Not only was the client company held to be the worker's employer, in spite of the agreement language to the contrary, but the indemnification provision offered no help because the court determined that the liability was not caused by any negligence of leasing firm.

The *Atchley* decision, if nothing else, should put client companies on notice that a leasing arrangement does not provide a client company with absolute immunity against employment law claims. Such a company still needs to be careful. The best practice is to maintain regular contact with leasing firm professionals. Moreover, all employment-related issues affecting leased employees should be handled by the leasing firm, not the client company. In evaluating whether a leased worker qualifies as an employee of a client company, the guidance offered below should be considered. In *Hunt v. State of Missouri, Department of Corrections*,[159] the client company was determined to be the Title VII employer along with the staffing company. The court utilized a hybrid test (common law augmented by "economic realities") to find that they were employees because the client oversaw recruitment, provided the workplace and all equipment, established all procedures, approved time cards, constantly supervised the workers, and financed all compensation. While for other purposes, such as employment taxes, these workers may have been employees of the staffing company, dual status existed for Title VII purposes.

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[155] *Clackamas Gastroenterology Assocs*., *P.C. v. Wells*, 538 U.S. 440 (2003) (applying the common law agency test to determine the existence of employment relationship under the ADA).

[156] 166 F.3d 1290 (9th Cir. 1999), *cert. denied*, 528 U.S. 816 (1999).

[157] 2002 U.S. Dist. LEXIS 14308 (E.D. Ill. Aug. 2, 2002), *aff'd*, 2003 U.S. App. LEXIS 8067 (7th Cir. Apr. 29, 2003).

[158] 180 F.3d. 1143 (10th Cir. 1999).

[159] 297 F.3d 735 (8th Cir. 2002).

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The Title VII analysis of employee status for independent contractors applies equally to leasing arrangements.[160] The problem here is that a client of an employee-leasing organization may be found liable for inappropriate acts of a supervisor with respect to an employee where both the employee and the supervisor were provided by the leasing organization. The client may have little or no control over such a situation. Alternatively, if the supervisor is employed by the client and the victim is employed by the leasing company, the leasing company may have little control. Once again, the fact-specific analysis necessitates an investigation of the leasing organization and an appropriate indemnity agreement with clearly delineated rights and responsibilities.

In addition, companies using leased employees should be aware of potential liability under the Equal Pay Act (EPA). In general, this statute prohibits gender discrimination regarding the payment of wages. It requires equal pay for "equal work on jobs the performance of which requires equal skill, effort, and responsibility, and that are performed under similar working conditions."[161] It is unclear how the courts will treat disparate pay for leased employees. Clients may avoid problems by making EPA liability an explicit part of an indemnity agreement with the leasing organization.

§ 24.2.6(i)(iii)

EEOC Enforcement Guidance on Applying EEO Laws to Contingent Workers

The U.S. Equal Employment Opportunity Commission (EEOC) has provided guidance regarding how Title VII, the Age Discrimination in Employment Act (ADEA), the Americans with Disabilities Act (ADA), and the EPA apply to individuals who are hired by temporary employment agencies, contract firms, and other staffing firms, but whose working conditions are controlled in whole or in part by the businesses to which they are assigned.[162] The EEOC provides guidance by answering common questions affecting Equal Employment Opportunity (EEO) coverage and liability laws regarding contingent workers.

Coverage Issues

According to the EEOC, contingent workers are generally protected under EEO laws because they typically qualify as employees of the temporary agency, the company to which they are assigned (*i.e.*, the client), or both. While employees are covered under EEO, ADA, and ADEA laws, independent contractors are not.[163] A worker is an employee if the right to control the means and manner of his or her work performance rests with the temporary agency and/or the client rather than with the worker himself or herself. The guidance stresses

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[160] *Amarnare v. Merrill Lynch*, *Pierce*, *Fenner & Smith*, *Inc*., 611 F. Supp. 344 (S.D.N.Y. 1984), *aff'd*, 770 F.2d 157 (2d Cir. 1985).

[161] 29 U.S.C. § 206(d)(1) (2008).

[162] EEOC Compliance Man. (BNA) N:3317.

[163] Although independent contractors are not protected by EEO laws, they may be protected under section 1981 of the Civil Rights Act of 1866, whose substantive elements are "generally identical to the elements of an employment discrimination claim under Title VII." *Brown v. J. Kaz, Inc.*, 581 F.3d 175, 181-82 (3d Cir. 2009). Section 1981 provides that "all persons . . . shall have the same right . . . to make and enforce contracts . . . as is enjoyed by white citizens." 42 U.S.C. § 1981(a). Several courts of appeal have held that an independent contractor may bring a discrimination claim under "section 1981 for discrimination occurring within the scope of the independent contractor relationship." *Brown*, 581 F.3d 175; *see also Taylor v. ADS, Inc.*, 327 F.3d 579, 581 (7th Cir. 2003); *Webster v. Fulton County*, 283 F.3d 1254, 1257 (11th Cir. 2002); *Danco, Inc. v. Wal-Mart Stores, Inc.*, 178 F.3d 8, 13-14 (1st Cir. 1999), *modified by* 79 Fair. Empl. Prac. Cas. (BNA) 1737 (1st Cir. 1999).

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that all aspects of the worker's relationship with the temporary agency and the client be considered in determining whether he or she is an employee.

Title VII Liability Extended Beyond Traditional Worker Relationships

The specific contour of Title VII's coverage extends beyond the traditional employment relationship. A decision that illustrates the third-party liability concept is *Moland v. Bil-Mar Foods*.[164] *Moland* involved a plaintiff who was employed by IBP and asserted a Title VII claim against a different company, namely, Bil-Mar Foods, for sexual harassment and unlawful retaliation for reporting the sexual harassment.

In concept, the federal district court in *Moland* held that an employee of Company X can bring a Title VII action against Company Y, even though Y is not his employer, if Y's discriminatory conduct interferes with his employment with Company X. Framing the issue in those precise terms, the court held that Moland stated valid Title VII claims against Bil-Mar for sexual harassment and unlawful retaliation for reporting an alleged sexual harassment, based on a finding that Bil-Mar's actionable conduct interfered with Moland's employment with IBP.

An even broader application of Title VII occurred in *Kudatzky v. Galbreath Co*.[165] In this case, the court held that an employer can be liable under Title VII for the sexual harassment of its employee, even though: (1) the harasser was a non-employee (*e.g.*, an independent contractor); and (2) the harassment took place at a client's location.

The plaintiff in *Galbreath* was a licensed real estate salesperson who was hired by Galbreath to manage an office building owned by one of Galbreath's clients. Although the plaintiff was employed by Galbreath, all of her services were performed at a client's office building that she managed. The plaintiff claims that she was repeatedly sexually harassed by an employee of the client who owned the office building. The plaintiff sued Galbreath, claiming that it violated Title VII by failing to protect her against a hostile environment.

The court observed that the EEOC guidelines state that:

> An employer may . . . be responsible for the acts of non-employees, with respect to sexual harassment of employees in the workplace, where the employer (or its agents or supervisory employees) knows or should have known of the conduct and fails to take immediate or appropriate corrective action.[166]

While acknowledging that employers generally cannot be held liable for harassment that occurs outside of the employer's workplace,[167] the court interpreted the current trend as holding employers liable for harassment committed by non-employees, when the harassment occurred in the employee's workplace and the employer knew of the harassment but failed to act.[168]

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[164] 994 F. Supp. 1061 (N.D. Iowa 1998).

[165] 1997 U.S. Dist. LEXIS 14445 (S.D.N.Y. Sept. 23, 1997).

[166] *Id.* at *11 (quoting 29 C.F.R. § 1604.11(e)).

[167] Citing *Whitaker v. Carney*, 778 F.2d 216 (5th Cir. 1985), *cert. denied*, 479 U.S. 813 (1986).

[168] Citing *Powell v. Las Vegas Hilton Corp*., 841 F. Supp. 1024 (D. Nev. 1992); *see also Velez v. Roche*, 335 F. Supp. 2d 1022 (N.D. Cal. 2004) (holding that the plaintiff could assert a claim for hostile

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As an example of this trend, the court mentioned the U.S. Court of Appeals for the Ninth Circuit's decision in *Folkerson v. Circus Circus Enterprises*,[169] in which the court recognized that an employer may be liable for the sexual harassment perpetrated by a non-employee, where the employer either ratified or acquiesced in the harassment. Ratification or acquiescence, according to the Ninth Circuit, can occur by an employer failing to take immediate or corrective action when it knew, or should have known, of the inappropriate conduct.[170]

In *Galbreath*, the court found that the allegedly offensive conduct took place outside of Galbreath's corporate offices and on the premises of a client. The court reasoned, however, that Title VII is designed to protect employees against sexual harassment in the workplace — irrespective of whether an employee's workplace is on the premises of the employer or at a different location. Inasmuch as the plaintiff in *Galbreath*, by the nature of her job, was required to work at a client location, the court determined that it would defeat the purpose of Title VII to absolve Galbreath of any liability simply because the plaintiff's workplace is at a location other than premises owned by Galbreath.

The *Galbreath* decision indicates that for purposes of Title VII, a company that engages independent contractors to perform services under circumstances where the contractors interact with the company's own employees, the company could be liable to its employees under Title VII for sexual harassment committed by the contractors.[171]

§ 24.2.6(j)

Americans with Disabilities Act (ADA)

The common law agency test applies to the ADA.[172]

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work environment against an indirect employer when the indirect employer caused the hostile work environment or when it had the power to stop the hostile work environment such that its failure to do so constituted interference with the terms, conditions or privileges of the plaintiff's direct employment).

[169] 107 F.3d 754 (9th Cir. 1997).

[170] *See also Woods-Pirozzi v. Nabisco Foods*, 675 A.2d 684 (N.J. Super. Ct. App. Div. 1996) (holding that an employer can be liable for the sexual harassment perpetrated by an independent contractor).

[171] *See also Halpert v. Manhattan Apartments Inc.*, 580 F.3d 86 (2d Cir. 2009) (employers may be held liable under the ADEA for discrimination by independent contractors if the employer authorizes them to make hiring decisions on its behalf).

[172] *Clackamas Gastroenterology Assocs*., *P.C. v. Wells*, 538 U.S. 440 (2003). However, in certain jurisdictions, that test may be irrelevant for workers seeking to bring disability claims under the Rehabilitation Act of 1973, 29 U.S.C. section 701 *et seq*., which covers disabled persons "subjected to discrimination under any program or activity receiving Federal financial assistance." *Fleming v. Yuma Reg'l Med. Ctr.*, 2009 U.S. App. LEXIS 25406 (9th Cir. Nov. 12, 2009) (quoting 29 U.S.C. § 794(a)). The Ninth Circuit Court of Appeals recently held that independent contractors *are* covered under section 504 of the Rehabilitation Act. The court reasoned that the Rehabilitation Act is broader than the ADA, and following the reasoning of the Tenth Circuit, concluded that section 504 "addresses only the substantive standards for determining *what* conduct violates the Rehabilitation Act, not the definition of *who* is covered under the Rehabilitation Act." *Id.* at *15 (quoting *Schrader v. Ray*, 296 F.3d 968, 972 (10th Cir. 2002)). However, the Sixth and Eighth Circuits have not reached the same conclusion. *See Wojewski v. Rapid City Reg'l Hosp., Inc.*, 450 F.3d 338, 345 (8th Cir. 2006) (holding the Rehabilitation Act does not apply to independent contractors); *Hiler v. Brown*, 177 F.3d 542, 545 n.5 (6th Cir. 1999) (noting that the "ADA, ADEA, and the Rehabilitation Act borrowed the definition of 'employer' from Title VII").

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§ 24.2.6(k)

Unemployment Insurance Laws

Employers are required to pay to the state an unemployment insurance tax for all wages the employer pays. When a firm and client company allocate payroll responsibilities to the firm, the firm is the party most likely to be responsible for remitting such payments. If the firm fails to make these payments, however, the client company would be secondarily liable as a co-employer. State laws vary with respect to whether unemployment insurance contributions must be made under the client company's or the firm's registration number.

In order to avoid any penalties for failing to pay unemployment insurance tax, firms and client companies alike are advised to seek legal counsel to determine which entity is obligated to pay unemployment insurance tax under a particular state's law.

§ 24.2.7

G. LEGAL ISSUES CONCERNING TEMPORARY & PART-TIME EMPLOYEES

§ 24.2.7(a)

Wage-and-Hour Considerations

The FLSA requires an employer to keep accurate records of the hours worked by an employee and pay minimum wage as well as any applicable overtime. Employers of part-time employees must consider whether wage thresholds for various purposes under the FLSA are cumulative for employees working for more than one employer in a relevant period. For example, the FLSA sets the minimum pay an employee must earn before an employer may enforce a garnishment order against that individual's wages. However, what happens when an employee works for two employers on a part-time basis during a relevant period? If that employee's wages from each employer are insufficient to meet this threshold, but the combined wages from both employers meet the threshold, can either employer garnish the employee's wages? The answer is no.[173] However, different rules may apply to different wage thresholds, and employers should take care to follow the appropriate rules.

§ 24.2.7(b)

Employee Benefits: ERISA & COBRA

Temporary and part-time workers will be entitled to full ERISA rights if they are included in the terms of the relevant plan. The IRS has previously issued a directive to its field agents stating that pension plans that exclude employees solely on the basis of their temporary part-time status risk losing their tax-qualified status under the Internal Revenue Code. For a more detailed analysis of rules applicable to employee benefit plans, consult Chapter 25, "Employee Benefit Plans," of THE NATIONAL EMPLOYER®.

In January 1998, the Sixth Circuit Court of Appeals held that a contributing employer to a multiemployer pension plan was required to make contributions on behalf of its part-time employees despite the fact that terms in the employer's collective bargaining agreement with the union excluded part-time employees. The court found that the pension plan's standard

[173] *See* Op. WH 110 (1971).

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collective bargaining clause, which required participating employers to contribute on behalf of part-time employees, had become a part of the collective bargaining agreement between the employer and union. It concluded that the standard clause was an amendment or supplementation to the collective bargaining agreement. The court ruled that its finding in favor of the part-time employees was consistent with the pension plan's rules and regulations, which offered benefits to part-time employees.[174]

Employees going from full-time employment to part-time employment (or the independent contractor status) may be entitled to COBRA continuation coverage, due to the fact that their reduction in work hours no longer qualifies them for employer-provided medical benefits.[175] An event that causes a qualified beneficiary (employee, spouse, or dependent child) to lose medical coverage under the employer's plan is considered a qualifying event under COBRA. Coverage cannot be reduced or eliminated in anticipation of a qualifying event. If it is, this change is disregarded in deciding whether the event causes a loss of coverage. COBRA obligations are discussed more fully in Chapter 26, "Continuing Healthcare" of THE NATIONAL EMPLOYER®.

A voluntary termination of employment or reduction of hours remains a qualifying event. With the exception of gross misconduct, the circumstances connected with the termination of employment or reduction in working hours, are irrelevant.

§ 24.2.7(c)

Labor Relations & Union Obligations: The NLRA

Temporary and part-time employees receive special treatment under the NLRA. For a more thorough discussion of bargaining units and employer obligations, under the NLRA, see Chapter 31, "Union Organizing," and Chapter 32, "Collective Bargaining," of THE NATIONAL EMPLOYER®. In determining the appropriate scope of a collective bargaining unit, regular part-time employees are normally included unless the parties stipulate otherwise.[176] The same test for unit inclusion applies to both regular part-time and dual-function employees — that is, "whether the employee is regularly employed for sufficient periods of time to demonstrate that he, along with the [regular] full-time employees, has a substantial interest in the unit's wages, hours, and conditions of employment."[177]

In contrast, temporary employees are usually excluded from unit determinations.[178] In the consolidated appeals of *M.B. Sturgis, Inc.* and *Jeffboat Division*,[179] the NLRB held that employees of a temporary staffing agency assigned to another company can be combined to form a single bargaining unit without employer consent if the temporary agency and its client qualify as "joint employers" and the two groups of employees share a community of interest. As a result, both employers would be obliged to negotiate with the union. Prior to *Sturgis*, such combination required employer consent.[180] Hence, the Board found such leased employees to be "jointly employed" with a shared community of interest. To avoid such

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[174] *Bakery & Confectionery Union v. New Bakery Co.*, 133 F.3d 955 (6th Cir. 1998).

[175] I.R.C. § 4980B(f)(3)(B).

[176] *Bachmann Uxbridge Worsted Corp.*, 109 N.L.R.B. 868 (1954).

[177] *Berea Pub. Co.*, 140 N.L.R.B. 516, 518-19 (1963); *Engineered Storage Prods. Co.*, 334 N.L.R.B. 138 (2001).

[178] *Westinghouse Air Brake Co.* (*Swissvale Pa.*), 119 N.L.R.B. 1391 (1958).

[179] 331 N.L.R.B. 1298 (2000), *overruled in part by H.S. Care, LLC.*, 343 N.L.R.B. 659 (2004).

[180] *Lee Hosp.*, 300 N.L.R.B. 947 (1990), *overruled by M.B. Sturgis, Inc.*, 331 N.L.R.B. 1298 (2000).

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consequences, employers should develop a leasing contract that avoids one or both of these elements. For example, the contract may require that the leasing company be regularly involved in the supervision of its employees or that the tenure of services by temporary employees at any one user site is limited.

Under certain circumstances, a temporary employee may be allowed to vote in a NLRB election, even though the temporary classification is not included within the described bargaining unit. In determining voting eligibility of temporary workers, the NLRB has applied the date-certain test. Under the date-certain test, an employee who is hired on a temporary basis but whose term of employment remains uncertain because a final termination date has not been established is eligible to vote so long as he was working on both the initial eligibility date and the date of the election. At least two courts reviewing this test have held that the date-certain test is the correct test to apply in the situation of a temporary worker.[181] Thus, employers utilizing temporary employees should identify a specific termination date and, if later desired, may extend that date as necessary. The Second Circuit Court of Appeals has applied both the date-certain test and the reasonable-expectations test in determining voter eligibility of temporary workers. Under the reasonable-expectations test, an employee's reasonable expectations of permanent employment within the bargaining unit are considered.[182] In contrast to temporary workers, regular part-time employees performing bargaining unit work are eligible to vote in union elections, although there is at least one industry-specific exception.[183]

To the extent that temporary or part-time employees are provided by an employment agency or labor broker, please see the discussion regarding Labor Relations under the Employee Leasing section, above.

§ 24.2.7(d)

Employment Discrimination

A smaller employer must consider whether using part-time and temporary workers affects the number of its employees for purposes of meeting the jurisdictional thresholds under Title VII and the ADEA. Title VII defines an *employer* as "a person engaged in an industry affecting commerce who has 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year."[184] The same definition applies under the ADEA, but the threshold number is 20 employees.[185] There had been an ongoing disagreement among the circuit courts of appeals with regard to the appropriate method for counting the employees. The question was whether under the statutes the employer was to count and include only those employees working on each particular day, or include all employees on the employer's payroll regardless of whether the employee was working on a particular day. In 1997, the U.S. Supreme Court resolved the conflict between the circuit courts in the decision of *Walters v. Metropolitan Educational Enterprises.*[186] In *Walters*, the Supreme Court held that the payroll method was the proper method to determine whether an

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[181] *See NLRB v. S.R.D.C., Inc.*, 45 F.3d 328 (9th Cir. 1995); *NLRB v. New England Lithographic Co.*, 589 F.2d 29, 32 (1st Cir. 1978).

[182] *Kinney Drugs v. NLRB*, 74 F.3d 1419 (2d Cir. 1996).

[183] *See Motz Poultry Co.*, 244 N.L.R.B. 573 (1979); *New York Univ.*, 205 N.L.R.B. 4 (1973) (excluding part-time college faculty).

[184] 42 U.S.C. § 2000e(b) (2008).

[185] 29 U.S.C. § 630(b) (2008).

[186] 519 U.S. 202 (1997).

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employer had a sufficient number of employees to be covered by Title VII. The Court found the necessary employment relationship exists when the employer employs 15 or more employees during each payroll period in 20 or more weeks during the year in question. The Court believed that such an employment relationship was most readily demonstrated by the employees' appearance on the employer's payroll whether or not they worked on a specific day during the payroll period. It is important to note that once the statutory minimum is met, part-time employees are entitled to the protections of these statutes.[187]

§ 24.2.7(e)

Temporary & Part-Time Employees Are Also Treated Differently Under WARN

Temporary employees on the employer's payroll are counted toward the threshold number of employees for jurisdictional purposes.[188] They also must be counted in determining whether a plant closing or mass layoff has occurred.[189] However, they are not entitled to notice if: (1) the plant closing is due to the completion of a particular project or undertaking; and (2) the affected employees were hired with the understanding that their employment was limited to the duration of that project or undertaking.[190] This exclusion from providing notice to temporary workers can apply to work that is "seasonal but recurring."[191] However, *permanent seasonal employees*, that is, employees who are laid off with a clear expectation of being recalled each year are not "temporary" workers under WARN, and therefore are entitled to notice.[192] In addition, although a business may have "seasonal" fluctuations in its workload, if the employees are not hired for a specific contract or project they are not "temporary."[193]

Part-time employment has a special definition under WARN that applies if, and only if, the employee was employed for an average of fewer than 20 hours per week or fewer than six of the 12 months preceding the WARN notice date.[194] Part-time employees are entitled to notice under the WARN Act.[195] But they generally are not counted toward the WARN Act thresholds.[196] Part-time employees *are* counted, however, in determining employer coverage under the alternative 4,000 hours of work per week test. [197]

WARN requirements are discussed more fully in Chapter 16, "Reductions in Force," of THE NATIONAL EMPLOYER®.

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[187] *Graves v. Women's Prof'l Rodeo Assoc.*, 708 F. Supp. 233 (W.D. Ark. 1989), *aff'd*, 907 F.2d 71 (8th Cir. 1990).

[188] 20 C.F.R. § 639.3(a)(3) (2008).

[189] *Id.* § 639.3(c)(2); DOL comments to 20 C.F.R. §§ 639.3(c), 639.5(a) (2007).

[190] *Id.* § 639.5(c).

[191] *Id.* § 639.5(c)(3).

[192] *Marques v. Telles Ranch, Inc.*, 867 F. Supp. 1438, 1443-44 (N.D. Cal. 1994), *aff'd*, 131 F.3d 1331 (9th Cir. 1997).

[193] *Washington v. Aircap Indus. Corp.*, 831 F. Supp. 1292, 1297 (D.S.C. 1993).

[194] 20 C.F.R. § 639.3(h) (2008).

[195] *Id.* § 639.6(b).

[196] *Id.* § 639.3(a), (b), (c).

[197] *Id.* § 639.3(a)(1)(ii); *Hollowell v. Orleans Reg'l Hosp. L.L.C.*, 217 F.3d 379, 384 n.6 (5th Cir. 2000).

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§ 24.2.7(f)

Specialized Employment Agreements

Companies frequently are interested in hiring specialized employees for limited periods of time. An executive may be hired to turn around a particular department. Specialists may be hired to implement a new computer system. When such temporary employees are released, problems may arise. Most of these problems can be avoided by agreeing to appropriate severance terms when entering into temporary arrangements.

An employment agreement for specialized temporary employees should clearly set the term of employment and conditions of severance. It should also clearly set out the job duties and any applicable performance expectations. The term, although fixed at the outset, may be renewable to provide flexibility. The agreement should also provide for early termination of the agreement with or without cause and without a set amount of notice.

Because companies often expose specialized temporary employees to sensitive or confidential information, appropriate restrictive covenants may be required as part of the employment agreement. In some states, the employee may agree not to compete with the employer for a time after the period of employment. Such an agreement must be appropriately limited in its length and geographic scope. In addition, the employee should agree to keep confidential all proprietary and confidential information, including any trade secrets. Chapter 20, "Restrictive Covenants & Trade Secrets," of THE NATIONAL EMPLOYER® contains a more detailed discussion of trade secrets and covenants not to compete.

Finally, the agreement may contain an arbitration clause. No contract is devoid of uncertainty, and disputes will sometimes arise. An agreement to arbitrate all disputes over the proper interpretation of the agreement should operate to save both party's substantial time and money. Until 2002, pronouncements of at least one federal court of appeals had threatened the enforceability of mandatory arbitration clauses in employment contracts.[198] However, the Ninth Circuit expressly overruled *Duffield* in *EEOC v. Luce, Forward, Hamilton & Scripps*.[199] Fortunately for employers, state and federal courts now appear willing to enforce mandatory arbitration clauses in employment contracts. Chapter 10, "Employer-Initiated Arbitration Policies," of THE NATIONAL EMPLOYER® contains a complete discussion of arbitration agreements as well as useful prototype language.

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[198] *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir. 1998), *overruled by EEOC v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742 (9th Cir. 2003); *Craft v. Campbell Soup Co.*, 161 F.3d 1199 (9th Cir. 1998), *overruled in part by Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).

[199] 303 F.3d 994 (9th Cir. 2002), *aff'd en banc*, 345 F. 3d 742 (9th Cir. 2003).

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§ 24.3

III. PRACTICAL RECOMMENDATIONS

§ 24.3.1

A. STRUCTURING A SUCCESSFUL EMPLOYEE LEASING RELATIONSHIP

The following general guidelines will increase the likelihood that a firm will qualify as a co-employer:

- The firm's duty to pay wages to workers should not be conditioned on receipt of funds from a client company.
- The firm should bill client companies a flat hourly rate without any disclosure of the allocation of the hourly rate as between wages, payroll taxes, benefits, and profit. Where possible, the firm should not inform the client company of the wage rate being paid to employees (this is especially important for federal income tax purposes).[200]
- The firm should conduct periodic on-site visits to assess and address human resource issues. Ideally, this would be done by assigning to a client company a firm representative.
- The record keeping and reporting of hours worked should be handled by the firm, not the client company.
- The client company should not maintain any employment records apart from emergency information.
- The firm should be responsible for conducting employee evaluations and taking action based on those evaluations.
- The firm should assume all personnel responsibilities for the employees.
- Although the firm could consider input provided by a company on hiring and firing decisions, the firm should retain the ultimate right to make such decisions.
- The client company should direct all internal and external communications pertaining to human resource issues to the client company's firm representative.

While not all of the foregoing is absolutely necessary in order to establish a successful firm/ client company relationship, these factors serve to provide a general sense of the type of relationship that would be needed in order for a firm to qualify as a common law employer of workers who perform services for client companies.

[200] *See*, *e.g.*, *In re Prof'l Sec. Servs.*, 162 B.R. 901 (E.D. Mich. 1993).

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§ 24.3.1(a)

Relationship Between the Firm & Workers

The following guidelines should be considered in structuring the relationship that a firm will have with workers:

- The firm should maintain an employee handbook that applies to all workers. The handbook would instruct workers to:
  - report the number of hours worked to a designated firm employee;
  - communicate any work-related complaints or injuries to a designated firm employee or through a special 800 number;
  - comply with a stated dress code;
  - always represent themselves to third parties as employees of the firm;
  - always carry a firm employee identification card during normal work hours; and
  - comply with other employment policies established by the firm.
- The handbook also should describe the employee benefits that are available through the firm and advise workers of the firm's employee review procedure and its procedure for appeal of a contested review.
- The firm should have its own standardized guidelines for expense reimbursement, including a fixed *per diem* for out-of-town travel.
- The firm should establish its own vacation pay policy to apply to all workers.
- The firm should maintain all employee records.
- Workers should report their hours worked to the firm so that the firm can calculate the amount of wages payable and the applicable payroll taxes. This information (other than hours worked) should not be shared with client companies.
- The firm should retain the right to hire and fire.
  - Although a firm could consider advice provided by a client company on hiring and firing decisions, the firm should be the party that retains the ultimate right to make such decisions.
  - If a client company becomes dissatisfied with a worker's performance and the firm disagreed with the client company's assessment, the firm could seek to transfer the individual away from the complaining client company to a different client company that operates in a similar line of business.
  - The firm should handle all screening of, and perform all background checks for, employment applicants.
  - The firm should perform drug testing when necessary and appropriate.
- The firm should provide workers with a periodic employee newsletter reiterating its role as employer. The newsletter would, for example:
  - remind workers of the 800 number to use for communicating important information to the firm;

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  - advise workers of relevant information concerning employee benefit programs, *e.g.*, open season for health benefit plans;
  - advertise for job openings at different client company locations (if deemed appropriate and not offensive to client companies); and
  - advise workers of any changes in applicable employment policies.
- All workers should sign an employment agreement with the firm. The agreement should:
  - contain a noncompete provision that restricts a worker from performing similar services for the client company other than as an employee of the firm for a specified period of time after termination of employment with the firm, unless the firm waives the restriction;
  - prohibit workers from moonlighting without the firm's permission;
  - authorize the firm to transfer a worker from one client company to another; and
  - state that the firm and the worker each have the right to terminate the employment arrangement at any time for any reason.
- The firm should establish all policies for complying with applicable federal laws and regulations (*e.g.*, Fed-OSH Act, EPA, and applicable employment laws).
- The firm should provide all managers and supervisors with manager training to educate them on how to comply with applicable federal laws and regulations. The training would be mandatory.
- Supervisors and managers who work in similar industries should be required to attend an annual firm meeting where the individuals would meet to develop a best-practices approach for complying with the federal laws and regulations that apply to their industry. Discussion of business or production methods would be prohibited.
- The firm should be responsible for conducting employee evaluations and taking action based on those evaluations.

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THE LITTLER REPORT

THE EMERGING NEW WORKFORCE:

Employment and Labor Law Solutions for Contract Workers, Temporaries, and Flex-Workers

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THE EMERGING NEW WORKFORCE:
2009 Employment and Labor Law Solutions for Contract Workers, Temporaries, and Flex-Workers

I. INTRODUCTION

The current economic recession, characterized by former Federal Reserve Chairman Alan Greenspan as the "longest and deepest" since the "Great Depression" of the 1930s,[1] has immersed employers in a battle to reduce labor costs. In the instant era of downsizing, the principal focus has become immediate survival planning. Layoffs, overhead cost cuts, cost audits, and other efforts to simply remain afloat are the reality for management across the nation. But, unquestionably, another day is coming. Many economists now predict that the recession, which began in 2007, will end or be in its final stages in the second half of 2009.[2]

With expectations (and hopes) that the recession will be over in 2010, what should employers do to take immediate advantage of the coming upturn as it impacts the labor force? One option is to remain rigidly focused on containing costs while waiting for the recovery. This approach is all too common not necessarily as a conscious choice, but as a condition of paralysis when encountering deep disappointment. The price paid for failing to plan for the coming changes will be the loss of competitive advantage. Employers that prepare now for the new emerging workforce of 2010 will be far better positioned to embrace the new workforce and meet legal compliance requirements.

The purpose of this Report is to provide employers with the tools to prepare *now* for the employment and labor law challenges they will likely face when the post-recession workforce emerges. Littler predicts that "contingent workers" will constitute, on average, a full 50% of the new source of workers to whom employers will turn as the recession ends.[3] The result of this trend will be that contingent workers will make up approximately 25% of the total workforce, and this percentage will continue to increase.

The trend towards using skilled workers on a temporary, project-by-project, basis is not new, but will become increasingly visible as employers seek to efficiently increase and manage their labor pools following the recession. As far back as the mid-1990s, the MIT Sloan School of Management posited shifting networks of contingent workers as one possible scenario for the workforce of 2015.[4] Based on industry research and trends, the scenario envisioned by MIT as possible in 2015 is now likely to become a reality in 2010 — five years early — as a result of rapid changes caused by the recession. The deep economic contraction has been far greater that anything forecast in the 1990s, resulting in the likely loss of more than six million jobs. Accordingly, an opportunity has opened to refill these positions with a higher percentage of contingent workers.

A. An MIT Model for 21st Century Organizations: "Shifting Networks of Small Firms"

To provide employers a realistic vision of what to expect in the post-recession workforce, Littler has consulted with Professor Robert J. Laubacher from MIT, who co-chaired a groundbreaking study at the MIT Sloan School of Management aimed at envisioning scenarios for future organizational structures. In 1994, MIT began a multi-year research and education initiative titled *Inventing the Organizations of the 21st Century*.[5] A key focus was developing coherent scenarios of possible structures of future organizations. The scenarios were intended not as predictions, but rather as visions of potential alternative ways of organizing work and structuring business enterprises in the next century. The scenario process employed a range of techniques, including research, brainstorming, story telling, and sketching narrative accounts delineating the boundaries of what could conceivably occur. MIT framed potential scenarios focusing on what the world would be like in the year 2015, future ways of organizing work and businesses worldwide, and the effects of future organizational forms on economic and non-economic aspects of life for individuals and society. From 1994 to 1997, the possible scenarios were reviewed by and discussed with hundreds of business executives, academics, and consultants.

MIT predicted that five variables would likely be the most important driving forces for businesses of the future: (1) technology; (2) human aspirations (*i.e.*, what will people in the future want?); (3) global economic, political, and physical environment; (4) complexity (*i.e.*, will the world continue to become more complex?); and (5) demographics (in particular, the shift of population and wealth away from North America and Western Europe).

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Considering these elements, the MIT study focused on the *size* of individual companies of the future. Technological advances, allowing instant communication through the Internet and e-mail, globalization, increased education and expertise, and generational differences were addressed as having the potential to result in companies having smaller regular workforces, but increasingly relying on enormous networks of contingent workers.

The smaller companies envisioned by MIT would have large, temporary networks of thousands of contingent workers. These skilled workers would come together to form temporary organizations or "virtual companies" that would exist only until the project bringing the network together was completed.

MIT posited that many large corporations of the 20th century were simply a transitional form of business emerging from the industrial revolution. Before the industrial revolution, most Americans were self-employed as, for example, farmers, shopkeepers, or artisans, and belonged to a series of institutions, including professional associations and local communities that provided means for finding jobs, sharing learning and skills, and meeting with peers. After the Industrial Revolution occurred in the 19th century, American workers became more closely tied to the employing organization, which they depended upon for everything from benefits to professional development to socializing.

The MIT study envisioned that, during the next organizational phase, the model used in the entertainment and construction industries could become the norm rather than the exception. For example, Hollywood film production companies have long used a business model that brings together talented employees from various sectors, from actors to caterers, to complete a specific project. Once one film is completed, the temporary workforce is already transitioning to the next movie or other production.

The first element of the scenario envisioned by MIT is "fluid networks for organizing tasks." If this scenario were reality, nearly every task would be performed by autonomous teams of between one and ten contingent workers. Companies would submit requests for proposals or otherwise advertise project needs, receive responses from staffing firms and hire workers principally on an *ad hoc* basis. Work for individuals would be project-based, with freelancers able to bid for new assignments based on their circumstances and preferences. Flexible schedules and telecommuting would become the rule rather than the exception.

The second element is the emergence of more stable communities to which people would belong as they move from project to project. The "free agent" model would change the dynamics of society in that, unlike during the Industrial Revolution, the workplace would no longer be a principal source of social interaction or professional networking. Nor would workers rely upon employers for professional development, health insurance, or retirement savings plans. MIT hypothesized that independent organizations would evolve for social networking, learning, reputation-building, and income smoothing. Such organizations might include professional societies, unions, alumni associations, churches, political parties, service clubs, fraternal orders, neighborhoods, and families/clans.

The MIT study recognized the concern that life for independent workers could be difficult, with a continual need to find work and a lack of social interactions. The desirability of this scenario ultimately depended upon the emergence of new organizations to take on the "life maintenance" role that has been played by employers since the Industrial Revolution. In an article dated October 1997, Professors Laubacher and Malone further addressed the need for additional social networking capabilities for "free agent" workers.[6] Daily socializing around the coffee machine or chance encounters in the hallway provide employees not only with social interactions and bonds, but also with opportunities to share knowledge. These workplace encounters must be replaced by "either actual or virtual" meeting places "where workers with similar experiences might gather on a regular basis to trade stories and share advice." In 1997, MIT noted a then "recent phenomenon" in which young professionals began keeping in close contact via e-mail with networks of friends from college and the workplace. These seedling virtual networks allowed professionals to quickly share information about technological advances or available jobs, resulting in a "virtual network" serving "as a combination continuing education course and placement center."

Another element addressed by the MIT study was increased availability of information through the Internet, which could change the face of marketing and organizational structures. MIT hypothesized that, in the future, companies could market their products either: (1) as Nike has done, as a quality certification brand name for goods created entirely by outsourcing; (2) through brokers acting as intermediaries between buyers and sellers; or (3) entirely through electronic means, such as online networks or collaborative filtering.[7] The final result of these trends

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would be a world in which information is so readily available, (*e.g.*, through the Internet, and consumers' access to it so seamless that there could be no need for brands or intermediaries to link sellers and buyers). Word about new products would be passed almost instantaneously to thousands of individuals via e-mail and bulletin board postings.

B. The Littler Prediction: Contingent Workers Will Comprise 50% of the U.S. Workforce Added After the Recession

With a focus not towards whether the business model envisioned by MIT would be economically viable or prudent for any particular business, but rather towards addressing existing employment trends, Littler predicts that the MIT "scenario" of smaller companies with networks of contingent workers will become a *reality* for many employers. Not every business will look this way. But the MIT model will become an option that companies increasingly use to obtain highly skilled, temporary labor for projects ranging from computer programming to attorney contract work to human resources, marketing and accounting. As a result of downsizing during the recession, many employers will find themselves without sufficient labor immediately available to meet post-recession opportunities. Other employers may wish to take a conservative approach to recovering from the recession by obtaining costly expertise on a contract basis rather than hiring full-time employees. Still other employers will institute or increase efforts towards a comprehensive contingent workforce management program, adding contingent workers to meet long-term goals.

Littler predicts that, assuming the recession is ending or has ended, 50% of the workforce added in 2010 will be made up of one form or another of contingent workers. As a result, approximately 25% to as high as 35% of the workforce will be made up of temporary workers, contractors, or other project-based labor. The numbers of professionals working in temporary or alternative work arrangements will continue to rise. Flexible work schedules and telecommuting will increase as companies turn towards practical solutions to efficiently complete tasks while retaining talented individuals.

This prediction is strongly supported by the numbers that staffing industry experts have already witnessed. The best and most comprehensive research and analysis firm covering the contingent workforce is Staffing Industry Analysts, Inc. (SIA), located in Los Altos, California.[8] Ron Mester, Managing Director, reports that SIA's research data is consistent with and supportive of the Littler prediction.[9] A survey taken during the current recession showed that 73% of large companies[10] anticipate increasing their current contingent workforce by a median of 25% between late 2008 and late 2010. One-third of large companies predicted contingent workforce growth of *50% or more*. According to Mester, this research "is consistent with Littler's estimate that 50% of jobs 're-filled' after this recession will be contingent."[11]

Moreover, a review of data regarding the 2001 recession provided by SIA shows that employer spending on contingent labor more than recovers following a recession. For example, in 2000, spending on temporary labor totaled approximately $81.5 billion. That number decreased during the recession, ultimately dipping to as low as $73.3 billion between 2001 and 2003. By 2006, that figure had not only recovered, but had *increased* to almost $95 billion. Spending on temporary labor and the number of temporary job holders has declined during the instant recession, as has spending across the board, as business demands decreased in many sectors. Use of contingent labor provides companies with a shock absorber for economic downturns, demonstrated by statistics showing that a higher percentage of contingent jobs than "regular" jobs are eliminated during recessions. According to the Contingent Workforce Strategies Magazine reports that "[t]emporary employment is a key indicator of the economy. Employers typically cut temps first before they begin cutting traditional workers. At the same time, the contingent component is more likely to grow first as the economy hits bottom and starts improving."[12] According to SIA, however, overall spending on temporary labor has more than doubled since 1995. Littler's prediction that employers will add increased numbers of contingent workers after the instant recession ends is consistent with historical data, as well as current trends.

Part of this trend is the increased use of contingent labor for professional skills. According to the Bureau of Labor Statistics, as compared to previous years, in 2005, independent contractors were more likely than those with traditional employment arrangements to be in management, business, and financial operations occupations.[13] SIA reports that spending on contingent labor has increasingly been for professional skills, rather than office/clerical or industrial workers. Currently, more than one-half of all money spent on temporary labor is for professional job skills. This demonstrates that employers are already turning to

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the contingent workforce to obtain highly skilled workers needed for particular projects at a fraction of the cost of hiring those professionals for full-time, regular employment.

Contributing towards the increase in the contingent workforce is the removal of certain prior barriers. First, American workers have historically depended on employers for economic stability with regard to benefits ranging from the most significant cost factor of health insurance to guided retirement savings programs. With a focus on competing globally, U.S. employers remain in dire need of ways to reduce health insurance costs. Many competitors are based in countries where health insurance is provided *by the government*, not employers. The escalating cost of health care has led U.S. companies to turn to contract workers or send work offshore to decrease labor costs in order to remain or become competitive on a global scale. However, many U.S. workers are simply not in a position to become "free agents" because of their reliance on employers for health insurance. There is currently a shift in the United States that may remove this barrier at least in part. Most significantly, President Obama has pledged both to decrease health care costs and to provide at least limited universal health care. In addition, with unemployment rising, many insurance companies have increased their promotion of affordable health insurance for individuals. Further, the rise in the number of dual-working families has also increased freelancing in situations where one spouse or partner has family benefits available from a full-time employer.

Second, the social isolation that the MIT study posited as the most significant barrier to a future workforce of "free agents" is avoided by the emergence of new technologies for instant communication and virtual social networking. From e-mail and instant messages to cell phones and text messages to Skype and other affordable video conferencing, a range of options now exists for workers working from home to instantly interact with contacts. Social networking is now conducted just as frequently, if not more frequently, through Internet and email as face-to-face interactions. A 2005 survey showed that workers in large companies now use e-mail more frequently than telephone calls to communicate on the job.[14] Significantly, the "virtual networks" envisioned by MIT scholars in 1997 have now arrived. MySpace, Facebook, and Twitter allow users to post "status updates" telling professional and social contacts what they are doing on a day-to-day basis. For example, Twitter advertises its virtual network as "a service for friends, family, and co-workers to communicate and stay connected through the exchange of quick, frequent answers to one simple question: What are you doing?"[15] LinkedIn advertises itself as a forum for professionals "to exchange information, ideas and opportunities."[16] 360 degree e-feedback for the workplace is now promised by Rypple, Inc.[17] These virtual networks allow users to maintain vast networks of social and professional contacts despite geographical distance.

The "virtual networks" that have emerged online are no longer just for teenagers. President Obama changed the face of political campaigning when he used online social networks to reach voters in unprecedented numbers, creating a model for future campaigns in what some have dubbed "the Facebook Campaign."[18] A survey conducted by the Pew Internet & American Life Project in late 2008 showed that the number of *adult* users of online social network sites has *more than quadrupled* since 2005 (from 8% to 35% of all adults).[19] Because adults make up a larger portion of the U.S. population than teens, the 35% figure means that a much larger total number of users of online social network sites are adults. It is true that younger adults are more likely than their older counterparts to use online social networks, probably because the younger generation grew up using the Internet and remains more technically savvy as a whole. An incredible 75% of adults aged 18 to 24 use online social networks. In comparison, that figure remains high at 57% for adults aged 25 to 34; and decreases to 30% for the 35 to 44 year old group, 19% for 45 to 54 years, 10% for 55 to 64 years, and just 7% for adults 65 years and older. Of those adults already using social networking sites, 37% log-in *daily*, as compared to 48% of teen users. These figures demonstrate that the use of online sites is likely to overtake other means of social networking as the workforce ages. However, use of the professional networking site, LinkedIn, is already popular with professionals of all ages. The median age of LinkedIn users is 40 years old, and users of that site are more likely to have college degrees than users of other networking sites. Online sites have arisen for everything from job placement (*e.g.*, Yahoo! Hotjobs and Monster.com) to alumni sites (*e.g.*, as Classmates.com and university sites) to community bulletin boards (*e.g.*, Craigslist.org) to peer review sites (*e.g.*, Yelp.com) to dating sites (*e.g.*, Match.com and eHarmony.com). The phenomenon of increased use of online social and professional networking sites, allowing workers to maintain a "virtual network" of hundreds if not thousands of contacts, and the rise of other technological means of instant communication have already decreased the

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reliance on the workplace for social interactions and increased the amount of information instantly available to workers and consumers.

Third, as the country emerges from a devastating recession and increased numbers of "Generation Y" members (those born between 1977 and 2002) enter the workforce, there will be a marked decrease in the "stigma" formerly associated with being a "consultant." According to the Bureau of Labor Statistics, in 2005, contingent workers were twice as likely to be under the age of 25.[20] As the ever-industrious "Baby Boomers" retire, we are also beginning to see workers from that generation turning to part-time consulting work in increasing numbers. A September 2005 report by the Canadian Management Centre opined, based on a survey by Ceridian Employer Services that younger people are more comfortable with "alternative" work arrangements than their older colleagues, including flexible scheduling, telecommuting, job sharing, and contingent jobs.[21] A staffing director at Nike opines that the transient Generation Y "will take on the label of independent contractor with great enthusiasm."[22]

Not only are younger technologically savvy workers more inclined to accept alternative jobs, but there is also a marked decline in the stigma attached to such work arrangements in public opinion generally. In 2005, the Bureau of Labor Statistics reported that more than one-half of temporary workers would have preferred a permanent job (but an incredible 82% of independent contractors preferred their work arrangement to a traditional job).[23] The negative perception of temporary work assignments is changing according to SIA, which reports that temporary employees now tend to rate their staffing agencies and temporary work assignments higher than their last regular, full-time employment position. Moreover, as the recession ends and intense emotions over layoffs wane, organizational cultures will become even more supportive of using contingent labor. SIA research shows that a shift is already in the works, with substantially more survey respondents indicating their organization discouraged use of contingent workers in 2004 than in 2008. No longer will the title "consultant," "contractor," or "temp" automatically be viewed as less desirable. Rather, those titles will undergo a real paradigm shift as employers embrace contingent workers of all skill levels and types as valuable assets to the post-recession workforce and an essential part of tomorrow's workplace.[24]

C. The 21st Century Workplace

The workplace of tomorrow will feature small, core management teams for key corporate functions such as management and strategic direction. The rest of the workplace will be radically different than what we have seen and experienced since the 1960s and the rise of big corporations that do most everything in-house. The emphasis and management direction will be to outsource all that can be accessed reliably and cost effectively on the outside. Like Nike athletic shoes (which are only designed and marketed in-house), business models will be based on and supported by a huge network of national and international suppliers for everything from human capital to logistics to manufacturing. Indeed, with workers moving in and out of a company's doors on a just-in-time, project-by-project basis, it will be difficult to determine how many people are working for or supporting a company at any given time. Yet, this model will give corporations the flexibility to be nimble and selective when staffing and supporting business functions and be strategic and precise in long-term project planning. The ability to staff up or down quickly will be of paramount importance in this new model, which in turn, creates new hurdles and headaches in dealing with rather archaic employment and labor laws designed for decades ago. Companies need to plan for the new future — now.

The radically different workplace will be perfect for the amazingly different workforce. The skilled workers who will join companies as contract labor will have the ability to work at their dream job each and every day. There will be no such thing as staying at a job you hate — each worker's skill set will be their greatest asset and those assets will be for sale — pitted against like talent, bid up based on depth and experience and sold to the highest bidder for discrete projects. Companies will line up to secure the coveted skills needed to complete their projects on a timely basis. Indeed, this workforce will be much like the one the U.S. Department of Labor says already exists — in which the average person has held 10.8 jobs by age 42.[25] The Bureau of Labor Statistics also reports that in January 2008 about 23% of workers over age 16 had tenure with their current employer of only 12 months or less. These statistics demonstrate that a substantial segment of American workers have been functioning almost as contract workers, frequently changing jobs and staying on some jobs for only a short period. In the past, workers holding "regular" jobs for short periods is, in essence, an insufficient form of contingent workers. These individuals have relied on their

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own resources to find employment, and employers have invested considerable amounts in these employees for recruitment and training. The contingent workforce of the future will result in increased efficiency as employers and workers alike turn to staffing agencies and online resources to find projects that will make the best use of available skill sets.

D. The Contingent Workforce in Action Today at U.S. Companies

Many companies are either ahead of the game or in the process of preparing to embrace the new workforce. For example, Cox Communications Inc., one of the largest cable providers in the United States, has created an initiative to improve the visibility and value of its contingent workforce. Cyndi Scallion, Cox's Corporate Employment Director, started with the company nine years ago as a contingent worker, providing recruitment and other human resources-related services. After five years, she became a "regular" employee, and is now in charge of Cox Communications' contingent workforce management program.

The growth in contingent workers experienced by Cox is consistent with the Littler prediction. Scallion tells Littler that approximately 28% of Cox Communications' labor will be provided by contingent workers by the end of 2009. The company has just under 25,000 regular employees and an additional contingent workforce of approximately 7,000. The largest increase in the contingent workforce at Cox has been in professional skill areas, which comprise more than half of the outside labor used by the company. Scallion anticipates that the number of contingent workers at Cox will increase after the recession ends, sharing the philosophy that the "ebbs and flows of business should be filled by contingent workers."

When Cox began its vendor management initiative, Scallion recalls, "we realized that Cox lacked visibility into the contingent workforce. We needed to accurately identify what the workforce consisted of." In the past, individual managers at each location were using outside labor without accurately reporting what their labor budget was being spent on. Now, Cox has instituted a sophisticated central management process, which has greatly improved visibility.

Knowing the make-up of its contingent workforce has allowed Cox to "achieve greater strategic planning for the future workforce," according to Scallion. Cox has undergone a process of analyzing the typical length of service for many regular employment positions that have traditionally existed at the Company. "If the data shows that a position only has an average of 18 months or less of service, knowing that figure allows us to make decisions about whether it would be more efficient to outsource that work." Implementing a contingent workforce management program has shown that it is more efficient for Cox to hire contractors to perform certain roles. For example, much of Cox's work, such as equipment upgrading and network building, is project-based. Using contingent workers allows Cox to employ the most skilled professionals for these projects when it is uncertain whether those skill sets will be needed in the long-term.

Cox Communications has clearly embraced the MIT model, viewing contingent workers as a valuable asset to the company. It is not alone. Recent reports indicate that Microsoft now has as many as 88,000 contingent workers, in addition to its 96,000 regular employees worldwide.[26] Eric Gregg, a managing partner at the Inavero Institute, was reported to have said that Microsoft's use of contingent workers is indicative of a broader trend, as "[i]t is no longer the case that companies view temporary and contract strategy as their 'contingent' workforce, but rather their flexible workforce," particularly in the technology sector where highly paid skills are often needed on a project-by-project basis. A spokesman for Microsoft confirmed that the large numbers are "within the ballpark," adding that the number of contingent workers "varies widely depending upon what's going on at any given time."[27]

Contingent Workforce Magazine reports that many companies, including Cisco and 3M, have implemented programs to increase the visibility and effectiveness of their contingent workforces.[28] Unquestionably, the "contingent workforce" is no longer a possible scenario for the future; that workforce has arrived and will become visible in increased numbers as the country emerges from the recession. The key question to be addressed now is, what should companies do today to be ready to usher the *Workforce of 2010* into the *Workplace of 2010*?

II. KEY EMPLOYMENT AND LABOR LAW ISSUES AND PRACTICAL STEPS

A. Overall Employment Law Compliance

1. Introduction

The movement toward a more decentralized workforce will take place within the forecasted increase in workplace regulation.

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The use of contingent workers and independent organizations to provide labor and talent creates new challenges for employment compliance. Addressing these challenges now will position businesses to seize the opportunities that will emerge in the evolving workplace of 2010 and beyond.

2. Key Areas

Human Resources Functions

An organization's success is tied directly to the workforce it can harness. The traditional employer-employee workforce approach is too rigid to adapt to the new workplace. Organizations will move toward a flexible contingent workforce and will outsource many functions now handled in-house. In response to this rapidly changing landscape, the current Human Resources position will transform to talent acquisition for specific projects.

At the core of this strategic role will be effective recruiting. Faced with a shrinking talent pool, changing demographics and a more transient workforce, Human Resources will need to find creative ways to recruit and manage an organization's talent pool. Strategic alliances and networks must be built and managed so that an organization can quickly adapt to volatile market forces and the organization's labor needs. This move toward contingent labor will allow for greater flexibility and management of workforce needs.

The intertwining of networks and a contractor-based workforce will create myriad legal issues for organizations. At the forefront is the potential creation of multiple joint employer relationships. Relational issues will arise regarding who is or is not an employee of an organization and thus, who "controls" or has obligations to the employee. Human Resources will need be mindful of this issue when establishing its alliances and networks and must insist that its outsource partners have procedures and policies in place to ensure legal compliance with fair employment laws. Such compliance will involve multiple state jurisdictions and globalization and will require Human Resources to look beyond this country's borders as it considers and evaluates legal compliance.

Discrimination

Firms are faced with a patchwork of laws regulating the potential discrimination impact of their employment decisions including Title VII of the Civil Rights Act (Title VII), the American with Disabilities Act (ADA), the Age Discrimination in Employment Act (ADEA), the Equal Pay Act (EPA), and the Civil Rights Acts of 1866, 1871, and 1991. State and local laws further complicate the regulatory picture for companies. In sum, these laws require that firms ensure all aspects of the employment relationship are without discrimination.

The desire to shield itself from liability for violation of these laws may motivate a company's decision to migrate to a decentralized, contract-based workforce. A decentralized workforce offers some protection from discrimination liability to the extent that hiring, firing, salary determinations, discipline, and discharge are made by the subcontractor or staffing agency. Indeed, current EEOC guidance acknowledges that a staffing company is responsible for compliance with the ADA where the employee is completely under the control of a staffing company.

However, this protection will be far from complete. In addition to prohibiting companies from discriminating against their own employees, Title VII, the ADEA, and the ADA also prohibit businesses from discriminatorily interfering with an individual's employment opportunities with another company. The ADA specifically prohibits interference with rights protected under the statute. While Title VII and the ADEA do not include comparable provisions, they prohibit discrimination against "individuals." Therefore, even in a fully decentralized workforce, a company may still face liability for discrimination against a contingent worker if it has the ability to thwart the creation or continuance of a direct employment relationship or where it has the ability to affect the terms, conditions, or privileges of employment of that worker.

The emerging workforce could significantly impact and complicate discrimination avoidance to the extent that decentralization undermines an institution's ability to impose consistent standards for decision-making, supervision, discipline, and training across the entire organization.

The situation is further complicated by the fact that a centralized antidiscrimination policy may increase the likelihood that a company will be found to be a joint employer of the staffing agency. Accordingly, an organization transitioning to a decentralized workforce should take care to require that the independent organizations with which it works have compliant discrimination policies and reporting procedures.

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Family and Medical Leave Act

In light of a workforce that may be evolving to one of extensive networks and individual contractors, companies may find their obligations to provide medical leave to workers subject to change. The Family and Medical Leave Act of 1993, as amended (FMLA), currently provides eligible employees of covered employers with up to 12 weeks of unpaid, job-protected medical leave during a 12-month period. *Eligible employees* include those who work at a worksite with 50 employees or who work for an employer with 50 or more employees within 75 surface miles of their worksite; have worked for the covered employer for at least 12 months; and have worked a minimum of 1,250 hours during the previous 12-month period. *Covered employers* include those with 50 or more employees, public agencies, and certain federal employers. The first step in determining whether a business is a covered employer and whether a worker will be eligible for FMLA benefits is for the employer to calculate its total number of employees.

Firms whose workforces are migrating from traditional workforces to one that is largely comprised of contract workers may find itself presented with some unique FMLA issues that currently confront joint employers,[29] including accurately calculating its total number of employees for FMLA purposes and determining to which employees it owes FMLA benefits. For joint employers, each organization, the primary employer and the secondary employer, must count its own permanent employees together with the employees it jointly employs to determine if it meets the 50 employee threshold. Thus, for firms shifting to a more contractor-based or small-firm based workforce, it is pertinent to identify and count both permanent employees and joint employees to ensure accurate and full compliance with the FMLA. This is true for small firms linked by networks as well.

Moreover, obligations under the FMLA may diminish if a company transitions from the role of a primary employer to that of a secondary employer under this new workforce. The primary employer of a joint employment relationship is generally the entity that exercises the most control over the employee(s), by having authority to hire and fire, make job assignments or placements, make payroll, and provide benefits.[30] The FMLA assigns greater obligations to primary employers than to secondary employers. Where the primary employer is responsible for affording required notices to the employee, providing leave, maintaining benefits, and restoring the employee to employment after leave, the secondary employer is responsible only for accepting employees returning from FMLA leave and refraining from discriminating, retaliating, or otherwise interfering with an employee's FMLA rights. Thus, any company that transitions its workforce, or anticipates such a transition, to contingent labor, should consider its relationship to each worker and whether it owes primary or secondary employer obligations to those individuals.

One final consideration is due to any organization that finds itself transitioning from the traditional workforce to one that contracts for services traditionally provided by a professional employer organization (PEO).[31] A PEO is generally not considered a joint employer with its clients for purposes of the FMLA. However, to the extent the PEO maintains the right to hire, fire, assign, direct and control the employees or benefits from the work that the employees perform, the relationship between the PEO and its client is one of joint employment, which raises primary and secondary employer issues under the FMLA.

Corporate Ethics & Whistleblowing Protections

The new Federal Sentencing Guidelines, amended November 1, 2008, include penalties for violating the Foreign Corrupt Practices Act (FCPA). The FCPA affects issuers of securities, domestic companies headquartered, organized, incorporated, or with a principal place of business in the United States, U.S. nationals, and, in certain circumstances, foreign individuals and entities, including subsidiaries and joint venture partners.[32] Expanded Sarbanes-Oxley requirements, recent federal guidelines and other amendments establish ethics and compliance guidelines for all organizations, not just publicly traded companies, and require periodic training on workplace ethics and compliance. Suddenly, ineffective compliance practices, inadequate training or ill-drafted codes of conduct can spiral not just into civil liability exposure, but can expose executives and managers to criminal prosecution.

Ushering an era of expanded whistleblower protection, the American Recovery and Reinvestment Act of 2009 (ARRA), contains sweeping new protections for public and private employees who blow the whistle on gross mismanagement or waste of covered funds, creation of public health or safety risks, or violation of laws or regulations relating to the grant of the funds. These measures apply to companies that receive contracts,

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subcontracts, grants or other payments funded in whole or in part by the federal stimulus package. In addition to creating significant new protection for employees, other provisions of the statute are likely to increase litigation. For example, section 1553 of the ARRA does not establish a statute of limitations, does not impose a statutory cap on damages, and prohibits waiver and arbitration of these claims.

The advent of a new workforce may create a double layer of compliance obligations. The first layer is the independent organization that makes the workers available to the company of tomorrow, operated primarily by a small group of core managers. When entering into contractual arrangements for contingent labor, the organization must take steps to ensure that the independent organizations that provided the workers have established procedures in place to address ethics obligations and whistleblowing protections. Further, the core organization should take steps to ensure that it has an effective corporate ethics and compliance program for its core group of managers and for any workers who provide services to advance its organizational goals. It is conceivable, and to be expected, that legislation will expand to cover the new reality of organizational structures and that the small company model will be held responsible for ethics compliance and protection for workers, whether true "employees" or not, who blow the whistle on the organization's practices that run afoul of these laws.

Successful organizations take proactive measures to prevent unethical and illegal conduct. Implementation of an effective ethics and compliance program includes policy requirements, reporting procedures, antiretaliation provisions, and training that provides managers, executives, and workers with skills for identifying required practices their companies must follow in resolving ethical dilemmas. Establishing such an ethics and compliance program can greatly reduce potential fines, liability, and litigation an organization may face. It is important to begin now to create and foster an organizational commitment to an ethical culture and an understanding of each individual's responsibilities for following applicable laws and regulations. Taking a proactive approach to ethics and whistleblower claims includes:

- Implementing a policy that includes prohibitions against discrimination and retaliation for reporting what employees reasonably believe to be wrongdoing of any kind — not just discrimination and harassment — and providing two avenues for reporting, one of which is outside of the employee's chain of command.
- Ensuring that complaints and claims are promptly investigated by someone within or outside of the company who is knowledgeable about the subject matter of the complaint (*e.g.* finance, health, safety).
- Educating managers and employees on compliance with laws, rules or regulations relating to the use of government funds, in addition to providing comprehensive training on awareness and prevention of whistleblower retaliation.

Taking these steps now will help organizations be poised to meet the challenges of the new workforce.

Recordkeeping

Initially, one might think that moving toward a more mobile, independent-contractor-based workforce may reduce the recordkeeping demands placed on companies. Organizations — soon free of the traditional "employer" role — may call upon the talent and skill sets they need without the administrative concerns of managing a large group of permanent employees. Unfortunately, the chances that federal administrative agencies will allow organizations to benefit from workers without lending them adequate protections are quite low — and assuming those agencies continue to require compliance with major employment legislation, someone, somewhere will have to document that compliance.

In contemplating how recordkeeping demands may change, consider one of the most basic components of human resources documentation — the all-powerful job description. Job descriptions cure a number of ills by:

- Helping organizations defend their hiring and testing practices under Title VII, the ADEA, and ADA;
- Establishing why someone is not entitled to overtime compensation under the Fair Labor Standards Act (FLSA);
- Substantiating pay practices to protect against discriminatory pay claims;
- Assisting in the dialogue regarding reasonable accommodations under the ADA;
- Providing underlying documentation in making difficult reduction-in-force decisions without taking into consideration impermissible factors such as age;

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- Helping determine the impact of work-related injuries and liability under state workers' compensation laws;
- Assisting in making legally-defensible promotion and transfer decisions.

Initially, the freedom from maintaining such excessive documentation on job functions will certainly provide relief for businesses. But from a practical standpoint, when forced to substantiate these types of decisions, the inability to directly observe and record how an employee spends his/her day may make everyday business decisions more difficult to justify than ever before.

Another hallmark of regular employees that may face dramatic changes is the use of and reliance upon the standard employment application. As an example, federal contractors subject to the Office of Federal Contract Compliance Programs (OFCCP) requirements currently face myriad issues related to tracking every individual who qualifies as an "applicant." Those organizations must solicit information about race, gender, and ethnic status for all job candidates who meet OFCCP's applicant definition, and maintain it for the preparation of affirmative action plans and responses to governmental audits. Traditional employers with centralized HR functions and sophisticated electronic applicant tracking systems struggle with current recordkeeping obligations as well as the difficulty of obtaining consistency across an entire organization.

The new workforce of mobile workers is expected to move about freely from organization to organization, and likely will not go through the rigorous pre-employment process (including completion of applications and self-identification forms) now expected of applicants for traditional employment. Companies will benefit from a standardized electronic tracking system whereby worker data is stored more centrally and is more accessible to the businesses for which these individuals perform work. On a positive note, however, such a change should ultimately provide greater consistency in the data that separate and distinct organizations have been unable to accomplish on their own thus far.

In addition, the new workforce will begin to rely almost exclusively on provider organizations for wages, rather than for the more traditional, paternal-type care provided by today's companies. While narrowing the scope of liability for other types of claims is appealing, businesses should expect to see increased enforcement of other types of legal obligations for which they are still responsible, such as those under federal and state wage and hour laws. Although maintaining the proper documentation to survive a Department of Labor (DOL) audit is no easy task in today's environment, the implications of payroll records, hours worked, timesheets, deductions, etc., that are associated with a completely transitory workforce will present entirely new challenges. Employees with the greatest talent will expect to move from firm to firm, subject to individual agreements that compensate them for their services and skills. In essence, the standardization that institutions have come to rely on in certain job categories or pay grades will be diminished by the need to compete on a case-by-case basis in the open market for these contracted employees.

The good news amid such changes is that in situations where recordkeeping has occupied expansive resources for many years, the burdens may become lighter:

- The need to extensively document terminations may be reduced by a lack of any expectation on the part of workers that they will have long-term employment;
- To the extent that workers rely on companies only for wages, the issues of fringe benefits, such as health insurance, retirement benefits and unemployment insurance may shift dramatically to the provider organizations and/or the individual workers; and
- The obligations to provide medical and personal leaves of absence can be shifted from the employing organization to the employee who schedules his/her own workload based on availability.

Ultimately, regardless of which entities end up bearing the responsibility as "employers" for these new workers, the federal recordkeeping obligations — and their state counterparts — will inevitably fall to someone. The new workforce model suggests that while companies may be relieved of duties they long to be rid of, the challenges of meeting the obligations they still have will be different and evolve over time.

Workplace Safety

The Federal Occupational Safety and Health Act (Fed-OSHA) defines *employee* as an employee of an employer who is employed in a business that affects commerce. The Act requires every employer to furnish a safe place of employment and to comply with all applicable occupational safety and health

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standards. An *employer* as defined in the Act is any person or entity that has employees and that is engaged in a business affecting commerce. Fed-OSHA has interpreted the term *employee* to include supervisors, partners, corporate officers, former employees, applicants for employment and, at least for the purposes of the antidiscrimination rules, employees of other employers. Fed-OSHA maintains that the existence of an employment relationship is based upon economic realities rather than legal definitions.

A body of case law exists to identify the proper employer for Fed-OSHA purposes in the context of a loaned employee. This context may prove analogous to the contingent worker situation. In the loaned employee cases, loaning organizations seek to disclaim liability under Fed-OSHA by shifting responsibility to the borrowing companies through different contractual arrangements. The Occupational Safety and Health Review Commission (OSHRC) has stated that even where a borrowing company has agreed to accept responsibility, "an employer remains accountable for the health and safety of its employees, wherever they work, and cannot divest itself of its obligations under the Act by contracting its responsibility to another employer." It is therefore unlikely that a contingent labor arrangement can free a company from ultimate Fed-OSHA responsibility for leased employees, if the company qualifies as the employer of affected workers for purposes of the OSHA statute.

3. Practical Steps to Take Today

In preparation for this decentralized workforce, companies should consider the following guidelines, mindful that the independent contractor option will be limited because of government's thirst for revenue from payroll taxes:

- Companies that have experience with independent contractors, joint employment relationships or other contract-based arrangements should review the lessons already learned from those existing relationships, including an evaluation of the sources of prior claims and litigation exposure, administrative burdens, and policy and procedure challenges. This type of preemptive evaluation positions companies to determine which vulnerabilities can be corrected before a larger scale version of that model becomes a day-to-day reality.
- As we move towards a more decentralized workforce, the obligations and duties for each entity in the relationship will vary for employment law compliance purposes. The obligations will hinge on whether the company's provider is an umbrella organization, a guild or network of skilled workers, a staffing organization providing services, or a PEO, as well as the types and duration of services contracted for and provided. Accordingly, if and when a company receives a complaint regarding discrimination, retaliation, harassment, safety, or interference with federally protected rights, it should always conduct its own investigation into the allegations. The specific type of business relationship it has with the provider organization will determine which responsibilities and duties rest with which entity.
- For any contract for services or joint employment relationship or agreement, the company must exercise vigilance in including antidiscrimination and indemnification clauses in all contracts to ensure that it is properly shielded from unnecessary liability.

B. Global Mobility

1. Help from Abroad

Geographic boundaries that once surrounded the workforce are quickly disappearing. A variety of factors and technological advancements have contributed to the establishment and development of a global labor market. Further, workers are no longer limiting themselves to one location. Rather, they are continually marketing their skills to organizations based anywhere in the world. In this global labor market, companies, are likewise increasingly reallocating workers to the projects and locations that provide the most cost effective and efficient use of their expertise.

With an eye toward the global labor market, U.S. companies with overseas facilities are finding a welcome reprieve from the current national economic woes. These multinational corporations are well positioned to maintain a viable global workforce during these tough national economic times in anticipation of an economic upswing in the foreseeable future. In addition, these corporations are finding creative alternatives to maintaining a substantial U.S. workforce including the development and use of the L-1 Intracompany Transferee visa program. This visa category allows an organization to bring an unlimited number of foreign workers into the United States from

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overseas entities that share common ownership and control. Eligible workers must have worked for the company outside of the United States for at least one year. A multinational corporation facing a downturn in the U.S. might, for example, assign a new hire to spend 12 months working in a country with looser immigration rules before bringing him or her to the United States.

The intracompany transferee program provides tremendous flexibility to the corporation in that it allows the U.S. entity to transfer the L-1 individual into the United States on a short or long-term project basis, leave the individual on the foreign entity payroll and benefits, and utilize the specialized services on an intermittent basis for the duration of the L-1 period. This provides a company with tremendous options in moving these individuals throughout the U.S. on a variety of projects where their expertise and services are needed. This also allows the U.S. organization to efficiently and effectively scale headcount up or down as business needs change.

Some companies have gone a step further by seeking alternatives to basing technlogy workers in the United States at all. They have found numerous advantages to creating teams of professionals based outside the United States who can easily be sent to countries where they are needed—for example, to support local rollouts of high-tech products. In a trend that has gained momentum in the past 18 months, companies have been creating sophisticated "global mobility" programs aimed at creating truly international career paths for professionals. Having learned that hastily planned transfers often leave employees and their families feeling out of place culturally, these companies now carefully screen employees before any transfers, monitor their satisfaction and performance during foreign assignments, and debrief them afterward about what did and did not go well. In this global mobility trend, it is imperative that organizations manage their people well. In the project-based model, an individual's information, knowledge, skills, and relationships are an organization's biggest asset and main source of competitive advantage. With people-related costs approaching more than two-thirds of organizational spending, the project-based model provides attractive alternatives if managed and implemented correctly.

Further, in the advent of the global mobility program, the importance of people to the bottom line is significant. As such, companies seeking this alternative must review the demographic, economic, technological, and socio-political make-up of their workforce on each project to ensure that the project is managed, overseen, implemented and directed in the most efficient manner. With a workforce that is more diverse, mobile, informed, and in demand, the management of people as well as the mobility program itself are vital to a corporation's growth, profit, and existence. Experience demonstrates that proper program implementation is paying off. Employees seem more satisfied with the experience, and the company benefits from workers' broader language and people skills and their greater knowledge of the company's operations. This workforce is flexible, mobile, and experienced. The key to making it work is establishing a thorough global mobility program that allows for the uninhibited movement from one country to another through prequalification or other immigration strategies that streamline the process for intracompany transferees throughout the world.

For the many large companies that have not yet developed global mobility programs, here are two reason to do so:

- **They help recruitment and retention.** Companies report that employees have come to see international mobility as a new way to distinguish themselves and as a positive career move.
- **Their start-up costs are not as high as one might think.** Many executives assume that a mobility program requires the firm's full incorporation in foreign countries. Not so. A low-cost branch office may be all that is needed, and companies have discovered it is often more cost-effective to send a team of trained professionals into a new country for a short-term project than to train local employees. There is a strategic benefit too: a faster, more flexible structure. When they are organized around projects, as opposed to locations, companies can enter new segments more quickly, reduce time to market, and enhance process standardization.

Having a trained, educated, project-based workforce can be a more cost effective approach than hiring a full-time, permanent employee in the global environment. A prime example of the benefit of using contract labor is flexibility by supplying already skilled workers and producing at maximum performance without a training curve. Contract labor is a great fit for projects that require a large workforce with specialized skills. These workers can be supplied on short notice for a day or a few months and have already been prescreened to determine the level of their expertise in a specific field. Independent contractors, who are

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proficient in the expertise needed or the technology being used, can begin producing results immediately, thereby eliminating the need for costly training and saving time.

2. Practical Steps to Take Today

- Explore foreign markets to determine viable locations for opening cost effective foreign operations.
- Identify key personnel to provide initial staffing for foreign operations.
- Begin overseas hiring with an eye toward developing expertise and skills that can be transferable across projects.
- Work with legal counsel to identify cross-border work authorization requirements to quickly facilitate the transfer of contract or project-based workers .

C. Worker Privacy & Technology

The ever-expanding ability to collect and manage increasingly large volumes of information about prospective and current employees raises opportunities and creates risks for businesses. Companies are now gaining an unprecedented capacity to screen applicants, track employee productivity, create online corporate communities and streamline data resources. At the same time, more prevalent and complex international, federal and state regulation of privacy and information security raise compliance costs and expose businesses to litigation risks associated with failed confidentiality measures and alleged discrimination. Companies can and should embrace these technology-driven benefits within the framework of forward-looking policies that fully account for the evolving framework of privacy and data protection law.

1. Major Challenges in the Areas of Privacy and Data Protection:

Vetting Prospects and Investigating Current Employees

As identity theft and theft of business information accelerate and legislators and regulators impose ever more onerous requirements to safeguard customer and employee data, companies are under increasing pressure to vet prospective and current employees. Indeed, most major players in the financial services, health care, and telecommunications industries will not hire someone, or even permit a vendor's employee to provide services, without subjecting that person to some form of background check. The decrease in long-term employees whose trustworthiness has been established over time only exacerbates the need for background investigation. At the same time, the vast popularity of "Web 2.0" has resulted in a flood of publicly available and readily accessible information about aspects of a prospect's or employee's personal life that formerly were known only to a small circle of acquaintances. To keep their customers and hire the "best and the brightest" while, at the same time, reducing the risk of lawsuits alleging discrimination or violation of the Fair Credit Reporting Act or state laws prohibiting adverse action based on lawful off-duty conduct, companies should now develop and implement policies that address: (1) the information sources that will be considered in the application vetting process; (2) the standards for evaluating that information; and (3) the procedures that will be followed for obtaining the information.

Creating Trust that Will Maintain the Flow of Information from Prospects and Employees

Just when companies need more information than ever before to vet prospects and workers, the prospects and workers are becoming more fearful of sharing information — particularly sensitive personal information, such as a Social Security number or health information — because of the endless stream of high profile security breaches and the costs of identity theft. In the 1990s and at the start of the millennium, organizations learned that enhanced privacy protections for consumer data provided a competitive edge in the marketplace for goods and services. Well into the new millennium, state legislatures are beginning to recognize the need to protect sensitive information, and a number of states have enacted laws to safeguard employee, applicant and consumer privacy. A focus on employee data protection will provide a competitive edge in the job market, particularly for multinational corporations whose workforces include citizens of the European Union and the British Commonwealth where data protection regulation is more robust. Firms can address this challenge and comply with relevant state laws through a multi-functional group, with representatives from Human Resources, Information Technology, the Legal Department and management who can provide guidance on how the organization will safeguard, use and disclose employee data.

Capitalizing on Web 2.0

Web 2.0, the interactive Internet, is here to stay, and it is not "just for kids" as demonstrated by the explosive growth of the social networking site Facebook among the "over-30 crowd." While social networking websites were constructed to foster teenage socializing, forward-looking companies already are

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seeking to convert this communication platform into a business tool. As one example, the chief executive officer of a major Boston-based hospital uses Internet networking to explain the hospital's anti-union stance to youthful rank-and-file, and a major automaker relies on an internal "business networking site" to foster communication among geographically and organizationally disparate components of the corporation. The advantages for large, geographically dispersed, or decentralized companies are particularly significant. Those firms can create communities across national or international lines and promote efficient use of corporate resources. As "Gen Facebook" matures and enters the workforce, its members will seamlessly employ enterprise-wide networking tools to get the job done.

Location Tracking and Other Employee Monitoring

Inexpensive computer chips loaded with radio frequency identification (RFID) technology as well as dashboard- and cell phone-based global positioning systems (GPS) now permit businesses to track their workforce both within and outside a facility. These location-tracking tools permit enhanced productivity, particularly for organizations with a mobile workforce. Meanwhile, increasingly sophisticated electronic monitoring technology can contemporaneously review and analyze virtually every communication and bit of data transmitted across a corporate network, helping to safeguard sensitive customer data and confidential business information. Pervasive monitoring, however, has its costs in adverse employee relations, especially in workplaces that are unionized or where a union is attempting to organize. In addition, changes in both communications and monitoring technology and several recently decided cases demonstrate that "antique" e-mail policies must be updated and revised policies need to be communicated to the workforce in a way that will create a positive spin rather than the specter of "Big Brother." Finally, electronic monitoring policies should contemplate a significant number of contingent workers.

2. Practical Steps to Take Today

- Determine and formalize a plan for selecting information sources that will be utilized to vet workers and prepare procedures and standards that will be followed to obtain information and evaluate information received.
- Include protocols in contracts with contingent worker providers that ensure company privacy requirements are met.
- Make certain that the company does not receive any unnecessary information about contingent workers.

D. Wage & Hour Concerns

The nation's wage laws are ill-equipped to govern the complexities of the modern organization. Enacted in 1938 to create jobs after the Great Depression, the Fair Labor Standards Act (FLSA) is designed to regulate hours of work in an economy where one in five workers is employed on a farm and the factory whistle signals the end of the urban workday. This Great Depression clockwork world bears little resemblance to the workplace we know today, and even less to the global workplace of the future.

The FLSA's very antiquity makes it an attractive weapon for aggrieved workers and the plaintiffs' bar. As businesses adapt to compete in the 21st century economy, wage and hour compliance is key to reducing employment liability. Smart companies will find ways to manage their labor needs efficiently even as FLSA actions adapt to target new wage practices. Savvy companies can make these essential changes now to prepare for the new workforce, while practicing preventative strategies for wage and hour liability. Successful companies will outsource inefficient business lines, form strategic alliances, and learn to manage core employees effectively. Each of the below three initiatives presents opportunities for success, but requires planning to minimize liability.

1. Independent Contractors: Outsource to Compete

Competition in the new economy requires focusing the business on core competencies at which the organization excels, and assigning other functions to outsiders who are equally efficient in their own field. Whether these outsiders are individuals, businesses, or labor pools, they can perform nonessential functions for a 21st century organization far more effectively than a department or line of a traditional corporation.

Entrepreneurs and existing companies should think creatively about outsourcing — beyond the call center or security desk and out to the routine functions that have carried over from the old model. Areas that may be suitable for contractor or consultant assignment and have been successfully outsourced include benefits administration, payroll processing, accounting, collections, warehouse operations, logistics, and even administrative or executive personnel. For example,

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growing companies or those facing a major strategic shift may bring in a consulting CFO on a temporary basis to guide the organization.

Outsourcing beyond established vendor tasks and into formerly core business areas requires careful planning, precise contractor agreements, and ongoing vigilance to ensure that the independent contractor relationship remains an asset to the organization. First, identify areas in which the company's non-integral functions can be handled by an independent contractor whose services are less expensive and more effective than those the company currently performs for itself. The company may also examine existing tasks or projects assigned to employees that might be better suited to the use of consultants or contractors. Assessing non-core functionality suitable to outsourcing also requires an understanding of how the contractor relationship can be structured to avoid FLSA and other legal liability.

To identify functions appropriate for complaint outsourcing, firms should consider:

- the nature and degree of control necessary for the work to be performed at a level consistent with company needs;
- the tools and equipment the contractor must invest in to perform the outsourced tasks;
- whether the tasks or projects assigned to the independent contractor require special skills or expertise;
- if the nature of the task or project is suitable to a payment structure based on deliverables other than hours worked;
- whether the task or function is one for which the company has a constant need or is required only periodically; and
- if the task or service is one that is an integral part of the business.

For wage law purposes, these are factors that courts, the Department of Labor, and the plaintiffs' bar will assess in determining whether the contract relationship is truly independent, or whether it subjects the company to liability as an employer of the contract labor. Where the independent contractor tends to work under little supervision, using tools and expertise applicable to other organizations, invoicing for goods or services rather than straight hours of work, and providing a function extraneous to the organization's core operations, the contracting company is less likely to be viewed as an employer.

Moving to a contractor or consultant model requires careful structuring of the outsourcing agreement. These sample best practices are starting points for planning a compliant and cost-effective agreement:

- prepare a thoroughly vetted form agreement that can be customized to fit the particular situation;
- pay independent contractors pre-negotiated fees for tasks or projects, rather than by hours worked;
- if an entire business function is not being outsourced, set a project or task end date to establish boundaries to the contractor relationship;
- consider appropriate indemnity, attorneys' fees, and liability clauses;
- make strategic choices about choice of law provisions;
- when possible, have the contractor perform all services off site; and
- when assessing contractor performance, evaluate contract compliance rather than performance of individuals.

To transition to this model beyond existing outsourced functions, companies should first examine the organization for inefficient or low-return business functions or groups. Then, identify potential functions for outsourcing and issue Request for Proposals (RFPs) to qualified contractors to determine whether making the transition will be cost effective. If results are favorable, employees performing these tasks can be identified and reviewed for reassignment. Existing employees should ***not*** be accepted into a contractor relationship. When the organization is prepared for outsourcing, the RFP process should go through a purchasing department with appropriate oversight, rather than a process equivalent to hiring. Finally, the company will be prepared to transition to the outsourced function. Periodic reviews of the contract relationship must be conducted to ensure that the contractor is both contributing to the organization's efficiency and complying with applicable standards for independent contractor status under wage and other laws.

2. Joint Ventures, Separate Liability

The new organizational model also involves establishing partnerships or joint projects to gain larger contracts and perform symbiotically. Careful companies will recognize that these relationships offer as many pitfalls as opportunities. Under the

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FLSA, entirely separate employers may be sufficiently connected to share liability as joint employers for each other's employees and employment practices. Joint employers are responsible, both individually and jointly, for compliance under the Act. Additionally, alternative causes of action, such as racketeering suits, may trap a compliant partner into liability for a vendor's illegal conduct. In practice, the financially stronger partner is likely to bear the burden of a partner's labor violations.

In an economy where ventures form for single projects and then disband, stable organizations will be increasingly attractive targets for plaintiffs. Companies must know with whom they are doing business and strategically manage joint ventures to avoid unnecessary liability.

Courts and the U.S. Department of Labor generally examine the "economic realities" of the relationship between the alleged employer and worker and weigh various factors to determine joint employment status. Companies engaged in joint ventures, outsourcing, or paying temporary workers can minimize the risk of joint-employer liability through established procedures.

- Identify areas where the retention of a temporary worker or workforce is the best means for completing existing or contemplated projects. When structuring the relationship, consult legal counsel and consider factors similar to those described above for establishing a valid contractor relationship.[33]
- Review existing relationships with contractors and sub-contractors to determine joint employment risks in light of these factors.
- Audit existing relationships and agreements with employee leasing firms, PEOs, and third-party providers. Establish objective criteria for approving these contracts, including: joint liability indemnification; the economic resources of the provider to meet contractual indemnification commitments; adequate compensation and benefits and a warranty of compliance with industry standards, including documentation of employment law systems and training.
- Consider establishing new relationships with compliant vendors, and issue RFPs to determine cost-effective alternative sources for labor functions.
- Consider drafting a policy to guide how the company will interact with its contingent workforce, and prepare other practices to lessen the risk that managers use contingent workers in an inappropriate manner.

These initial steps provide a basis for assessing some of the major risks in existing and anticipated relationships.

Careful policies allow companies to anticipate and avoid new wage law risks, such as suits brought by employees under the Racketeer Influenced and Corrupt Organizations (RICO) Act. In a new wave of RICO suits, companies doing business with vendors or partners who rely on illegal workers, sub-standard labor practices, or other disreputable cost-cutting measures may find themselves targeted by workers, whether legal or undocumented, in public allegations of labor exploitation.[34] These suits operate on a variety of novel and unproven theories, but inevitably involve adverse publicity around allegations such as human trafficking, wage-fixing, fraud, and extortion.

When a business partner's rates appear implausibly low or the contracting company observes signs that vendors are employing undocumented workers, steps must be taken to sever the relationship and establish contracts with reputable partners. Maintaining awareness of joint employment factors and auditing business relationships will reduce the risk of liability based on noncompliant wage practices of a vendor or partner.

3. Limited Workforce, Limitless Workspace

While a company may outsource or contract for non-essential tasks, it retains the best of its workforce to carry out core functions. Those employees, however, may work anywhere, under the wage laws of one or many states. Assume a scenario where a small company employs workers who live all over the United States, with each employee "telecommuting" to the company's "office" located in San Francisco. The company classifies its employees as exempt from overtime. Which state's law applies? California law — where the company's office is located — or the law of Arizona, Maine, or Florida, where its employees actually live and work from home? Can an employee working in Maine claim to be under California law if California law provides better remedies? Conversely, if Maine's laws are more favorable, can California residents claim remedies under Maine law because the classification decision was made by corporate counsel in Maine? What if the company's employees routinely make short business trips to other states? Does the law of each state the employee "works" in govern the employee's overtime eligibility or benefits?

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In determining whether to enforce a choice-of-law agreement or which state law governs an employment relationship, courts have generally used either a "significant-contacts" test or a "governmental-interests" test. Yet, perhaps because many employees are no longer required to be physically present at the place of business and can either choose or be expected to live and travel in other states, the law in this area is far from settled. Thus, some courts have held that any work performed while an employee is physically present in a state—even if only for a day—obligates the employer to comply with that state's employment laws.[35] In other cases, even if an employee has never set foot in a state he or she could attempt to claim the benefits of that state's laws if one of the decision-makers of the challenged policy happens to live there.

Companies can take several steps to protect themselves while wage and hour law in this area is still in flux. First, where the company or employee has significant ties—operating or living, working, or traveling—to highly regulated states such as California, employees should work under employment agreements that clearly designate which state's law will govern the employment relationship. While taking such a step will not guarantee a court's determination of which state's law will apply, not having any designation means that, whatever choice of law a company may have had, or would have liked to have had, it will play no part in a court's analysis of which state's law *actually* governs. Second, a firm should be cognizant of, and compliant with, the employment laws of not only the state where it is located and the states where its employees live, but also with the employment laws of those states to which, and through which, its employees travel, regardless of the actual amount of time they may spend in those states. Again, even if applicable state employment laws conflict, doing nothing risks exposing the company to unanticipated liability.

4. Practical Steps to Take Today

- Ensure that third-party providers of contingent workers have the financial means to meet indemnification agreements, which may result in larger providers becoming the preferred providers.
- Use a third-party vendor to investigate and audit all outside business partners to ensure, to the extent possible, that they comply with applicable wage law.
- Draft vendor, partner, and employment contracts to reduce liability and direct a forum for potential disputes, understanding that if contingent worker arrangements do not pass the economic realities test, there will be corporate veil piercing.

E. Executive Compensation

Executives generally consist of the group of employees tasked with the decision-making and strategic development of a company, including a chief executive officer (CEO), a chief financial officer (CFO), a chief operational officer (COO), a general counsel (GC) and a lead human resources executive (HRE). In a model of small companies in a large network of companies, executive services may be provided in two general ways: (1) each small company has its executive officers; or (2) similar services are bundled and provided to various small companies ("bundled services"). An example of the latter would be if one company housed the CFO, GC and HRE as quasi-outside advisors to each of the small companies. The difference between the bundled services and independent outside advisors is that the bundled services providers would have a pre-determined client base (similar to an in-house legal department) and objectives would not include seeking additional clients, but maintaining service to the pre-determined client base to which services are provided.[36]

1. Factors and Components of Executive Compensation

Often, the first step in determining executive compensation is benchmarking compensation to what other executives are receiving in the industry. While in a small company-large network model, benchmarking will be valuable, the company would also have to consider benchmarking within the company (as a large disparity of compensation in a small company has a higher negative impact on employee morale than in a larger company), as well as benchmarking within the network. Benchmarking within the network also keeps cost control in line for the services provided.

There are generally several components to executive compensation: base salary, short-term incentives and long-term incentives. In order for a small company to be successful, a major portion of the executive compensation should be tied to performance, rather than to mere continued employment. In the new business model, base salary will be relatively low compared to larger companies in the industry peer group, but there should

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be a proportionately larger upside for attainment of performance goals that add to the success of the company.

The model for performance-based compensation will be critical to the success of the individual small company as well as the network. Short-term incentives generally consist of a cash bonus based on the company's performance over the course of the year, as the company outlines pre-determined performance goals that are critical to its upcoming financial year. Long-term incentives are generally equity-based and tied to the company's performance over a period longer than a year. Rewards for performance can be tied to myriad goals depending upon the short-term or long-term strategic goals of the company, such as net profit, revenue, cash reserves or earnings per share, determined on an absolute basis or as compared to a peer group. Performance goals may also be tailored to the particular service provided by the executive. For example, the performance goals for an HRE may be a reduction in employee turnover.

After setting the compensation for executives, another consideration that a firm will address is whether to have an employment contract for services. The primary purposes for an employment agreement is to help the company entering into the agreement retain the executive (*e.g.*, by providing penalties to the company for termination such as in a severance provision) and set forth parameters of employment (*e.g.*, describing duties and defining cause), while protecting the executive by providing for post-termination compensation and benefits, in connection with an involuntary severance with or without a change in control. With smaller companies and a large network, a company must balance the constancy and assuredness that an employment agreement may provide with having the ability to be nimble and change its workforce. In the current environment, no severance is paid if an executive is terminated for cause, where cause is narrowly defined. In an environment where small companies need to be fluid to compete, poor performance should be a factor in a company being able to no longer utilize the service of an executive without the company being penalized by paying severance.

As performance-based compensation tends to vary year to year, companies may wish to provide financial planning tools to executives, such as a non-qualified deferred compensation plan, so that income taxes may be deferred and income provided upon retirement. Non-qualified deferred compensation plans generally allow executives to defer compensation beyond the amount allowed under a qualified deferred compensation plan, such as a 401(k) plan. By providing a non-qualified deferred compensation plan, the executive may regulate the flow of income over the course of his or her life. The deferral of compensation also helps a company smooth out its cash flow paid as compensation. The downside to non-qualified deferred compensation plans is that such plans are subject to creditors, and if the company becomes insolvent or bankrupt, the executive will lose his or her deferrals.

2. Bundling Services

One approach to certain executive services that the new business model may consider is bundled services, as mentioned above. All companies in the network would use the bundled services to not only reduce costs for redundant services, but also to provide continuity of services and cohesiveness on strategy across the network.

Generally, the bundled services group would not generate any income and compensation to the group needs to be provided by the network of companies that actually produce revenue and pay into a compensation pool. The compensation pool may consist of cash or a combination of equity and cash of each company. The provision of equity must comply with the granting documents of the company's equity plans, as well as applicable securities laws. Equity compensation typically aligns executive's decision-making with the long-term desires of shareholders. Stock ownership guidelines may also be established for bundled service providers. With a provision of payment from the network companies, the bonus pool concept of compensation should be used to determined the proper apportionment of the incoming cash and equity. Also, determination of performance-based incentives needs to be pre-established before the applicable short-term or long-term performance periods.

In addition, if executives are viewed as independent contractors, the service agreement will be structured in a very different manner than an employment agreement. For example, independent contractor agreements typically do not have severance clauses. In addition, the provisions allowing for involuntary termination or cancelling a contract typically have less constraints than the typical employment agreement.

For a group of executives providing bundled services, whether a non-qualified deferred compensation plan is appropriate should be considered. Generally, non-qualified deferred compensation plans are "top-hat" plans, established for a select group of management or highly compensated employees.

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If all or a majority of the employees in a company are "a select group of management or highly compensated employees," then the "top-hat" status no longer exists and the plan may become subject to ERISA, which requires adherence to funding, vesting and fiduciary rules.

3. Practical Steps to Take Today

- Companies should determine whether employment contracts are appropriate if heading towards the model of small companies/large networks. If employment contracts are in place, do not include automatic renewal clauses, consider not renewing the contract (which may result in a risk of losing the executive), and have shorter contract terms.
- Review compensation plans and determine whether the plans could be broadened so that independent contractors or consultants may participate.
- Monitor proposed and pending legislation as there will be efforts to control/limit executive compensation.

F. Traditional Labor Law

The "old" model of employment involved large dominant companies that provided full-time stable employment for many years to large groups of employees with multiple talents, roles and skill sets to produce a host of related (and sometimes unrelated) goods and services. These employers provided the perquisites and benefits of stable full-time employment, including stable income, training and professional development, insurance, retirement security, a sense of community and a significant source of individuals' social interactions and networking. The "new" model, by contrast, is comprised of much smaller, more nimble and autonomous teams of people, set up as independent contractors or small firms, linked by networks, coming together in temporary combinations for various projects and dissolving once the work is done.

From the perspective of labor law and collective bargaining, this new world poses challenges and opportunities for businesses with union relationships, for those that are union-free and wish to remain that way, as well as for organized labor itself.

1. Existing Union Relationships

Companies with existing union agreements may be best served by strengthening the overall relationship and negotiating the provisions needed for flexibility and to adopt to the new workforce model.

Companies should maintain and build on strong collaborative relationships where they may already exist. There are many highly successful, flexible and adaptive companies with employees who are represented for purposes of collective bargaining, but the hallmark of those relationships is a history of candor, honesty, trust and fair-dealing. Significant changes in the ways companies have to do business always present challenges and risks for all parties, including labor unions and the employees they represent. Those challenges are best met in situations where there is a core level of trust and confidence. This helps labor unions understand that their interests are ultimately tied to the long-term best interests of the businesses that employ their members, which helps all parties embrace change with confidence and imagination.

Critical components of successful labor agreements to make them adaptable for the future, will include the following:

- **The ability to subcontract work.** If the growing paradigm for work and successful enterprises is the appropriate use of smaller specialty firms that can do things better, faster and cheaper, companies must have the ability to utilize the best resources to produce their goods or provide services. This means, especially for "non-core" or "component" functions, organized labor will have to compete to keep this work in the bargaining unit and management will need to have the ability to select the best option.
- **The ability to flexibly assign work and avoid work jurisdiction disputes.** Companies need the ability to assign work across job classifications within a bargaining unit, or to non-unit employees or nonemployees, as collaborative working relationships involving a growing number of service providers on a particular job or work site become more and more prevalent. "Project labor agreements" to which all participating unions are parties have been used successfully for years on complex construction projects of long duration to minimize, for example, jurisdictional disputes. This may serve as a useful model for future collaborative working relationships on small as well as large projects.
- **Efficient means to address new or changed job classifications and functions.** The rate of change in the scope and content of work is likely to increase over time,

and labor-management agreements that have quick and efficient means to address these issues will fare better in the evolving world.

- **Efficient means for dispute resolution.** Binding arbitration is the preferred method of dispute resolution and has served the labor-management community well for many decades. But as the speed of change accelerates and the need to make staffing and organizational decisions increases, it will be important to have efficient, reliable and expedited means of resolving disputes over these issues in the future. Disputes over the organization and staffing of work are inherently difficult decisions to reverse once implemented, and expedited means of addressing and resolving those issues will be critical to timely decision-making in this evolving world of work. Informal channels of dialogue — such as the labor management committee to address problems involving unforeseen needs for organizational change may also become more prominent in the unionized workplace of the future.

2. Challenges for Unions

For unions, the changing landscape of the workplace presents both challenges and opportunities. On the one hand, the decrease in the number of large businesses with hundreds or thousands of regular full-time employees poses numerous challenges in terms of organizing large groups of members. On the other hand, to the extent that growing numbers of workers become part of a project-based work society, unions could play an increasing role in becoming both the source of project-based labor to companies and the source of the traditional perquisites of stable full-time employment to its members whose work lives are tied less and less to a specific company. This harkens back to the days of the union hiring hall where labor was obtained "as needed" on a daily, weekly or project basis from the union, which served as the recruiting and training ground for workers in certain crafts and industries.

A familiar modern model from which much could be learned are the guilds and unions that represent workers in the film industry, where work is often sporadic and members work for many different firms over time. The Screen Actor's Guild, as an example, provides to its members many of the perquisites of regular full-time employment in the context of a somewhat irregular, project-based work life, including insurance, retirement benefits, educational and professional development, as well as a sense of community that is often otherwise lost in a project-based work world.

Many unions and professional associations may refocus their energies and resources to this model, although they will certainly have competition from employment agencies and other organizations that will seek to fill this same void for the project-based worker. Companies that need labor — especially skilled labor on a sporadic or project basis may increasingly embrace such models, as they may offer a reliable source of skilled and specialized labor, and relieve the companies of the responsibilities of maintaining and administering fringe benefit programs for the project-based workers.

3. The Current Union-Free Environment

For companies that are union free and wish to remain that way, there are many opportunities and challenges, some familiar and some new:

- **Focus business and full-time regular employment opportunities on core competencies and mission.** These are the areas where employment now and in the future will likely provide the greatest stability and the greatest opportunity for high levels of employee satisfaction, competitive wages and benefits, job security and a shared sense of community and belonging. These kinds of workplaces are the most difficult for unions to organize.
- **Contract out to networks of high quality specialty suppliers and vendors those functions of the business that are not "core."** This is especially true for those where the demand for work is variable or project based, and where specialty firms have the edge in terms of talent, technology and effectiveness by virtue of their focused concentration on producing particular goods or providing particular services that are necessary elements or building blocks of what is provided to customers or clients. These are areas of operations which, if done "in-house," are typically less well managed and provide more uncertain opportunities for satisfying and stable employment, thereby creating heightened risks of union organizing.
- **Take great care in utilizing temporary workers.** In *M.B. Sturgis*[37] the National Labor Relations Board (NLRB) issued a controversial decision that overturned almost

30 years of NLRB precedent and permitted unions to organize a temporary staffing agency's employees together with the contracting employer's regular employees, without the consent of both the staffing agency and the contracting employer. Under this ruling, so long as the regular and agency employees in the petitioned-for bargaining unit shared a sufficient community of interest, the bargaining unit would be found appropriate. While this decision was reversed four years later, in *H.S. Care L.L.C.*,[38] there is always a risk under a new NLRB that the *Sturgis* approach would be embraced once again, and firms should plan for the use of temporary workers accordingly. Several options exist to minimize the risk of a "community of interest" finding even under *Sturgis*. First and foremost, consider utilizing a separate company with its own employees to perform discrete or separable functions that may have historically been handled by temporary workers. There are growing numbers of examples in manufacturing and service settings of teams of employees of different employers operating under "one roof" to perform their own separate functions, directed by their own employers, whose activities are networked together by the contracting business that brought them all together. If that is not a realistic option for the organization, take steps to minimize the integration of temporary agency employees with regular employees and to make clear that they do not share a "community of interests;" for example:

- o use "work modules" where activities of the temporary employees are physically separated from regular employees to some extent;
- o provide significant differences in wages, benefits and other conditions of employment;
- o ensure that the staffing agency has a supervisor on site who provides direction to the contingent workers (instead of the contracting company providing such direction); and/or
- o be vigilant about phasing out the use of temporary employees when the need is gone, or at least having material fluctuations in employment levels among the temporary workers that are radically distinct from the fluctuations in employment levels for the contracting employer's employees.

4. Practical Steps to Take Today

- The ability to subcontract must be dealt with now. Determine core competencies to be performed in-house and plan to outsource other functions. Companies must be able to efficiently use collaborative teams of regular employees and temporary workers, independent contractors and specialty suppliers and vendors.
- Re-shape collective bargaining units now. Anticipate that contingent workers will be combined with regular employees and that the law under *Sturgis* will return. Companies must weigh this scenario against efficiencies so that regular employees and contingent workers do not share a community of interest.
- Prepare for the need to subcontract non-core functions and an influx of contingent workers and revise job descriptions.

G. Trade Secrets & Intellectual Property Protection

1. Managing Trade Secrets and Preparing Appropriate Restrictive Covenants

The new world of a fluid, project-based workforce presents a special challenge for the protection of trade secrets and intellectual property. A recent study found that nearly 60% of employees who quit or are asked to leave their jobs secretly take proprietary data from their employers.[39] These numbers are startling for a workforce of regular employees who are supposed to develop bonds of loyalty to their employer. However, this study may show that workers are already viewing themselves as independent agents, and that the bonds of loyalty to the company that were a part of the old model are already breaking down.

Regardless of the causes behind the theft of trade secrets, this presents a major challenge for the new model of a flexible, contingent workforce. The need to protect trade secrets and intellectual property will only be magnified by the use of a mobile workforce of free agents that is constantly being assembled for different task-based projects and disbanded at the project's conclusion. Increased turnover of the workforce will provide greater opportunities for the theft of critical confidential information. What can companies do to prevent this loss of vital intellectual property?

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In the past, companies relied on (varied) state law on restrictive covenants and noncompete agreements to protect confidential information. In the future, the use of a highly mobile contingent workforce may make those covenants obsolete. For example, with a vast number of employees working for PEOs or other staffing agencies, and generally filling positions based on short-term needs, it may be difficult, if not impossible to enforce a covenant to prevent a worker who filled a critical project position for 90 days from working for a competitor for six months or a year. This will be especially true if the employer is a PEO or staffing agency. Worker mobility may become the paramount public interest, for both individuals and businesses who need their services, in a world of specialized free agents. If the touchstone of this new model is worker mobility, then courts may very well look less favorably on restrictive covenants than they have in the past.

Thus, to prepare for this new task-based workforce, companies need to implement a comprehensive program for the protection of trade secrets. Businesses need to take three basic steps. First, identify jobs and tasks that fit into the new model. Is it engineers, software programmers or salespersons who can be shifted to the project based model of organizing work? Then, identify what information or intellectual property those contingent workers will either create or have access to in the course of performing their duties. A clear understanding of the trade secrets and intellectual property at risk will be needed to implement effective policies. Second, review current agreements to protect confidential information. This review should include agreements with direct employees and agreements with PEOs or temporary agencies to make sure that any intellectual property developed by contingent workers becomes the intellectual property of the contracting company. Agreements can be prepared today that are tailored to specific projects by following some important guidelines:

- **Make sure the agreements properly and effectively assign all inventions and improvements created by the contingent worker during the project to the company.** Does it ensure that the work product belongs to the company? If not, revise all agreements with regular employees and agreements with PEOs and staffing agencies to accomplish this goal.
- **The agreement must properly define the relationship between the contingent worker and the company.** If the worker is actually an employee of the staffing agency, then the relationship must be defined, and the company must have the ability to secure confidential information.
- **The agreement requires a clear definition of the duties and responsibilities of the contingent worker.** By defining clearly the duties and responsibilities of the contingent worker, the company can define its obligation to protect and keep certain information confidential. The agreements with staffing agencies and PEOs must include language that appropriately protects confidential information.
- **The company must review its use of restrictive covenants to ensure they are appropriate under the applicable state laws.** The agreements must be appropriate for contingent workers for a court to enforce a covenant against a worker who completed a 90-day assignment. Be mindful that agreements appropriate for contingent workers may affect agreements with regular employees.

Finally, firms must look at how their computer systems create and store the electronic data to be used or accessed by the contingent workers. The company must develop policies and practices, along with technological firewalls to segregate, as much as possible, the work of these different project groups to prevent broader theft of information. In the modern digital era, workers can walk out with the equivalent of dozens of boxes of paper files concerning future projects, product development ideas, and sales and marketing plans and financial data all on a single thumb drive. The ability to prevent digital theft of trade secrets and confidential information is critical. A task force comprised of members of the company's Legal, Human Resources and Information Technology teams should be formed to investigate the steps that should be taken now to segregate and protect data on computers. Some of the steps that the task force should take include:

- Ensure that all work product is created is saved on the company servers and nothing is created or stored "off-line."
- Limit access, via separate servers, firewalls and/or password protections, to keep data cordoned off and limit access to data on a need to know basis. Determine whether data should be segregated and protected by department, by project, or some combination and what data the contingent workers will need to perform their duties and how access can be limited to only that data.

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- Determine the types of reports and materials contingent workers should provide on a regular basis to update the company on their progress so the company captures the full value of the work performed.
- Prevent the copying of materials onto portable drives or at least be able to detect what information has been downloaded and by whom without costly computer forensic analysis.
- Monitor emails to prevent contingent workers from emailing files to their home email addresses or to competitors.

These measures will help the company prepare for and create maximum value for the company from the talents of the new mobile workforce while protecting the critical confidential information of the company.

2. Practical Steps to Take Today

- Companies must review and revise all agreements to properly and effectively assign all inventions and improvements created by contingent workers during a project to the company. Agreements with contingent workers and with PEOs and staffing agencies should expressly state that the work product belongs to the company. The agreements should properly define the relationship between the contingent worker and the company. The agreements with contingent workers, staffing agencies and PEOs should also have language protecting confidential information.
- The Company should implement policies and practices concerning the use of computers and access to company computers and confidential information. Work product must be stored on company computers and not kept "off-line" on either the contingent worker's, the PEOs' or staffing agency's computers. All work product created is saved on the company servers to ensure all work product and inventions are kept by the company.
- Implement practices that limit access, via separate servers, firewalls and/or password protections to confidential data so contingent workers only have access to materials and data relevant to their project. The contingent workers should have access to data needed to perform their duties and should not be able to access other data, which should reduce the risk that confidential information could be misappropriated. The company should also implement data monitoring protocols to detect and prevent digital theft of trade secrets and confidential information, including downloading to removable drives or forwarding to outside email accounts.

H. Reductions In Force And WARN

1. Reductions in Force

In March 2009, the U.S. Department of Labor (DOL) announced that the current recession so far caused 5.1 million job losses for Americans, with 663,000 jobs lost in March alone, and that the unemployment rate was up to 8.5%.[40] There are no clear indicators telling us when the reductions in force will ease up, but even as companies continue implementing reductions in force, consideration must be given now to the economic recovery, and what the future ebb and flow of human capital should look like.

As companies contemplate doing business with a new workforce, those companies currently engaged in layoffs should look further down the road and decide how much of their operations lend themselves to engaging an outside service provider, and plan for additional cuts in the traditional workforce, and transitioning that work to service companies. The usual concerns present themselves in the new scenario, but there are peculiar concerns regarding statutes requiring the giving of notice under the federal Worker Adjustment and Retraining Notification Act[41] (WARN).

2. WARN

WARN is difficult enough to apply in the traditional work setting,[42] and determining whether it applies in the context of future downsizing within the new workforce presents its own additional complexities for both service providers and the companies that use them. Reduced to its essentials, WARN requires employers having as few as 100 or more employees to give 60-days' notice prior to a "plant closing" involving the termination of 50 or more employees at a single site (or an operating unit within a single site), and the same 60-days' notice prior to a "mass layoff" involving either 500 employment terminations at a single site of employment, or, if fewer, 50 or more employment terminations that constitute 33% of those working at a single site of employment.

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If there is an alteration in the size of the workforces, there is an open question as to whether employment losses suffered by employees of the service provider are to be combined with employment losses suffered by employees of the company to determine if WARN thresholds are met, such that notice is required. The confusion is created by the WARN regulations, which provide in relevant part:

> Under existing legal rules,…contractors…are treated as separate employers or as a part of the… contracting company depending upon the degree of their independence… Some of the factors to be considered in making this determination are (i) common ownership, (ii) common directors and/or officers, (iii) de facto exercise of control, (iv) unity of personnel policies emanating from a common source, and (v) the dependency of operations.[43]

While the definitions of plant closing and mass layoff turn on the number of full-time employees who suffer an "employment loss,"[44] neither the statute nor the regulations directly address whether a jointly-employed employee of a service provider suffers an "employment loss" and is therefore counted toward the notice triggering thresholds when the contracting company terminates its use of that worker. However, the regulation defining who is an "affected employee," which determines who is entitled to receive notice if WARN is triggered, states that contract employees are not "affected employees" of the business to which they are assigned, and therefore not entitled to notice.[45] A good argument can therefore be made that, in order for the DOL to have concluded in its WARN regulations that a service provider's employee (such as an agency "temp") is not an "affected employee" of the customer, the DOL must have determined that an agency temp does not suffer an "employment loss" when the customer terminates its use of the worker. This is because the definition of *affected employees* is "employees who may reasonably be expected to experience an employment loss as a consequence of a proposed plant closing or mass layoff by their employer."[46] In addition, it can be argued that a customer's termination of its use of an agency temp is not the kind of "employment loss" that Congress intended to address in the WARN Act, given that the worker's primary employment relationship is (arguably) with the temporary agency. Indeed, the contracting company really has no knowledge of, or control over, whether the service provider will in fact terminate the services of the worker in question, or reassign the worker to some other project.

Despite the foregoing arguments, there is a risk of a court concluding that jointly employed service provider employees should be counted in determining whether the contracting company has instituted a plant closing or mass layoff (*i.e.*, that service provider employees should be counted toward the 50 and 500 employment-loss thresholds and should be included in both the numerator and the denominator in applying the 33% test). This risk will be greatest in situations in which: (1) the worker was initially located by the contracting company and referred by the contracting company to the service provider; (2) the worker does not have a previous history of having been placed by the service provider at different customers; or (3) the contracting company has used the worker for an extended period of time.

WARN issues are present in two other new workforce situations as well: (1) where a company transfers its own employees to a service provider, and (2) when a contracting company decides to change its service provider vendors.

There is within WARN a sale of business exclusion, such that where a business is sold, the transfer of employment from seller to buyer is not deemed to cause an employment loss for the employees of the seller, even though there is a technical termination of employment occasioned by the change of employer.[47] When the DOL issued its WARN regulations, the agency squarely considered the question of whether the sale exclusion would apply where a company subcontracts part of its operations to a service provider, transfers employment of employees from itself to the service provider, and the employees involved do not lose a day's work (they just change employers, and essentially continue doing what they did before — just the same as what typically occurs in a sale). The DOL rejected the suggestion that no notice should be required "where work is contracted out and the contractor hires the former employer's old workers to perform the contracted work."[48] However, the issue remains unsettled. Based on the DOL's refusal to exclude WARN's application to this situation, where the only employment loss is technical, a company contemplating the transfer of a substantial part of its workforce to a service provider would be prudent to build sufficient time into the process for giving a formal WARN notice if the numbers are such that notice would be required if the employees being transferred were simply terminated.

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Similarly, the sale of business exclusion *may* not apply to a change of service providers, even though the new service provider hires substantially all of the replaced provider's employees, and thus the same employees continue to have the same jobs, albeit with different employers. This is so because there is no express change of vendor provision to be found in WARN (while there *is* a sale of business provision). However, the Tenth Circuit Court of Appeals looked into a change of vendor situation, and held that a covered sale *may* be found in a change of contractor situation, provided there is some exchange for consideration between the parties involved.[49] Similarly, the Seventh Circuit Court of Appeals addressed transfers of employment that resulted from a series of corporate transactions other than a standard sale of assets, and held that the WARN sale exclusion should apply because almost all of the employees did not miss a day's work and an "operating agreement that handed over the running of the plant . . . was the equivalent of a sale" for WARN purposes.[50] Thus a sale of part or all of an employer's business could be found in a change of vendor situation if there is a series of transactions consistent with the functional understanding of a sale. Material fact questions on this issue may require a trial over whether a "sale" has occurred.[51] Because this area is unsettled, a service provider should in its service contracts allow the termination process to occur in such a way that the service provider has time to give WARN notices upon cessation of providing services. If there is a replacement vendor, and not enough time to give WARN notices, the outgoing vendor would do well to enter into some kind of transaction with the incoming vendor, to establish indicia of a sale.

In an early WARN case involving a service provider, a hotel management company received short notice from the hotel owner that the hotel was closing, and the management company did not give 60-days' notice. The Second Circuit Court of Appeals suggested that the hotel management company, in order to meet its own WARN obligation, *should* have built sufficient mechanisms within its contract with the hotel owner to enable the management company to provide statutory WARN notice.[52] Another federal circuit court rejected the suggestion by the Second Circuit for a cancellation provision, and expressed the view that there is no such broad requirement placed on service providers.[53]

The WARN regulations allow for the possibility of unforeseen contract cancellations (which may allow a shorter notice period), and describes that event as follows: "A principal client's sudden and unexpected termination of a major contract with the employer."[54] The negative implication of this characterization of a contract termination *sudden and unexpected* suggests that there may be times when a major contract termination is *not* sudden or unexpected. The broad test is stated within the regulations as follows:

> The test for determining when business circumstances are not reasonably foreseeable focuses on an employer's business judgment. The employer must exercise such commercially reasonable business judgment as would a similarly situated employer in predicting the demands of its particular market.[55]

Where a contract renewal is coming up, and the service provider may receive less than 60-days' notice of non-renewal before the end of the contract term, the WARN regulations contemplate that a solution would be the giving of a conditional notice:

> Notice may be given conditional upon the occurrence or nonoccurrence of an event, such as the renewal of a major contract, only when the event is definite and the consequences of its occurrence or nonoccurrence will necessarily, in the normal course of business, lead to a covered plant closing or mass layoff less than 60 days after the event.[56]

The practical problem for a service provider giving conditional notice is that its star performers may immediately start looking for employment elsewhere, and may be gone when the contract is not cancelled, but renewed. To avoid all of these problems, a service provider should seek to have at least 60-days' (70-days' to be practical) notice from its contracting company for a non-renewal decision, so that notices can be drafted and timely distributed in the event of non-renewal.

Where a service provider is engaged for a specific project that will be temporary in nature, WARN compliance can be achieved without notice simply by making sure that the workers engaged for the project understand that their engagement is indeed temporary:

> c) Temporary employment. (1) No notice is required if the closing is of a temporary facility, or if the closing or layoff is the result of the completion of a particular project or undertaking, and the affected employees were hired with the understanding that

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their employment was limited to the duration of the facility or the project or undertaking.

(2) Employees must clearly understand at the time of hire that their employment is temporary. When such understandings exist will be determined by reference to employment contracts, collective bargaining agreements, or employment practices of an industry or a locality, but the burden of proof will lie with the employer to show that the temporary nature of the project or facility was clearly communicated should questions arise regarding the temporary employment understandings.[57]

***Note that the regulations focus on the *employment* being temporary and also on the *project* for which the employees are engaged as being temporary.** The burden that is squarely placed on the employer by the regulations can be met by clearly stating the nature of the temporary project in offer letters and other employment documents given to workers (and preferably signed by them) when they are engaged for the temporary project.

Of course, analysis of the federal WARN is not enough. Service providers and the companies that use them must also be aware of state laws that create WARN-like obligations. As of this writing, there are nine such local jurisdictions (California,[58] Hawaii,[59] Illinois,[60] Maine,[61] New Jersey,[62] New York,[63] Tennessee,[64] Wisconsin[65] and the Virgin Islands[66]). New York and the Virgin Islands require 90-days' notice. Further assessment should be given to the renewal and notice of non-renewal provisions of contracts for services performed in those jurisdictions.

3. Practical Steps to Take Today

- Plan now your likely timeline for the shift of employees from your company to a service provider, so you can provide timely WARN notice.
- Document that contingent workers are temporary workers and that the project for which they were engaged is only temporary in nature.
- If you are a service provider, make sure that your contract clauses providing cancellation and non-renewal rights of contracting companies give you enough time to provide WARN notice if your contract is cancelled or not renewed.

I. Workers' Compensation & Unemployment Insurance

1. Managing Workers' Compensation and Unemployment Insurance

A marketplace staffed with a high proportion of contingent workers can produce substantial cost savings to an organization with respect to workers' compensation and unemployment insurance premiums. It is assumed that either: (1) the vast majority of such workers would not be considered employees under existing workers' compensation and unemployment laws; or (2) the states would collectively amend existing law to allow individuals greater freedom and economic opportunity by allowing them to work as independent contractors.

The reduction in the size of an organization's employment ranks will have a swift impact on the firm's financial obligations as a result of changing workers' compensation and unemployment insurance premiums. However, simply reducing the headcount of an organization will not necessarily have a direct, or pro rata, decrease in those premiums. There are a number of factors that comprise the pricing of workers' compensation insurance and unemployment insurance that are not directly related to headcount.

2. Workers' Compensation Considerations

It is possible to outsource jobs and have as a consequence an *increase* in the cost of workers' compensation premiums and flat administrative costs associated with maintaining employees more likely to be injured and require time off. One important factor, among many, used to determine workers' compensation premiums is the National Council on Compensation Insurance (NCCI) classification for the business. As a general matter, governing classifications at a specific job or location (other than standard exceptions) producing the greatest amount of payroll becomes the classification for the business. For example, if production employees, such as machine operators, produce the greatest payroll when compared with other classifications, then the production classification will become the governing classification. In some instances, separate functions of the business will be separately rated. For example, an employer-operated daycare in a bank is rated separately from the bank, and the firm will have multiple classification codes. Certain classifications obviously carry a much higher risk than others. A firm with a governing classification for dangerous production work will carry

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a higher premium than a firm with a governing classification for office work.

A second important factor in setting workers' compensation premiums is a firm's experience rating, that is, the actual injury and claims experience. A work environment with exceptional OSHA compliance and exceptional safety experience (no or very few claims), but which has numerous jobs otherwise considered to be high risk could have a lower premium than a firm with lower risk positions but with dismal OSHA compliance and a high incidence of preventable injuries. This demonstrates that it is not always the case that a reduction in raw numbers of employees creates a cheaper workers' compensation premium. The key to reducing premiums is to have a workforce with a low-risk governing classification, an exceptional safety program and very low claims experience.

3. Unemployment Insurance Factors

Unemployment insurance premiums are calculated in a manner that is very similar to workers' compensation premiums. NCCI classification and historical claims experience are the primary factors driving the cost. Additionally, many states add surcharges, for example, half a penny per dollar of payroll to the premium cost. There is an unavoidable catch-22 with respect to unemployment insurance, however. While the premiums are calculated based upon a percentage of payroll, which will come down as the workforce shrinks, firms will create a surge in unemployment claims, which will only serve to increase the claims experience for some period of time.

4. Bridging the Gap in the New Workforce

Workers' compensation and unemployment systems are employer-funded social welfare programs. Presumably, the incidence of work-related injuries will trend with historical rates and the demand for services on a project basis will create a large pool of individuals that are not covered by workers' compensation and others who are between projects not eligible for unemployment insurance because they will not have been employed. As a result, social "life maintenance" communities would need to provide a mechanism to fill the void for contractors and allow for pooled risk coverage, much like the actors' unions presently provide.

An alternative consideration is the creation of 401(k)-style accounts that are funded by companies, industry groups, the contractors themselves and the government. For example, the company engaging a contractor for a project may agree to pay X pennies on the dollar as a surcharge, and would pay the surcharge, along with the contractor's portion, directly to a fund manager who would be responsible for procuring workers' compensation and unemployment insurance coverage for the contractor. This type of portable benefits package would provide contractors with the flexibility to be mobile but provide the overall system with stability in these social programs.

This alternative scenario would allow fund managers the potential to negotiate more cost effective rates by pooling much larger numbers of workers together than can traditional employers. As a practical matter, this style of social-service funding would require legislative action and stringent regulations by state and/or federal government agencies. Moreover, government would still find itself in a stop-gap role with respect to individuals that will inevitably remain uninsured. The utility of such a benefit account could extend to other areas, such as health care insurance.

5. Practical Steps to Take Today

- Companies should conduct an insurance review and risk analysis related to the loss of the limited liability and exclusive remedy benefits that workers' compensation provides in a new workforce model. Make sure that insurance includes coverage as a third-party in case a contingent worker is injured. There will no longer be workers' compensation preemption. Individuals who are presently limited to recovery of workers' compensation benefits will now be eligible to file civil lawsuits for personal injuries occasioned by the company's negligence, which have no limitation on the types and amounts of damages they are entitled to collect. General liability insurance premiums could increase dramatically and the imposition of punitive damages, typically not covered by general liability insurance, would become a self-insured risk.
- Companies should consider joining self-insurance pools or trusts with respect to workers' compensation insurance. Most states allow firms in common trades to join together and pool their collective work injury risk. If enough businesses join, this can be a substantial overall savings to the individual companies. The pools or trusts are then typically administered by a third-party administrator through a trustee.

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- Firms should conduct an extensive review of their workforce makeup as it relates to the computation of workers' compensation and unemployment insurance premiums. As managers consider the most efficient methods to outsource operations, also consider what type of workforce will remain in light of the potential cost of premiums. It could be more cost effective to jettison manufacturing operations rather than retain them, or, it may prove to be more financially advantageous to maintain a manufacturing operation and outsource marketing, supply chain, procurement and other functions. Not only will such a review prepare the company for a new workforce model, but will lead to a much better understanding of, and potential to reduce, present workers' compensation and unemployment costs.

J. Independent Staffing/Staffing Organizations

1. Procuring and Training Workers Through Staffing Agencies

Even before the recent economic downturn there was an increasing utilization of individual consultants/contractors and workers employed by or referred through third-party staffing agencies. While the use of these workers comes at a price, the belief is that using labor in this way reduces costs and facilitates the engagement and disengagement of workers more efficiently than through at-will employment. While, just in time use of workers is believed to be more cost effective, under the new workforce model, use of such workers will require efficient methods to:

- identify the specific resources/talent needed;
- identify agencies that can provide such resources; and
- prepare to contract with staffing agencies for the resources the company will need.

As part of the procurement process, staffing agencies and provider organizations must develop nondiscriminatory ways of offering, evaluating and engaging the services of workers. The provider organizations also must assume (and utilizing companies must require) the obligation to train workers — both initially and on an ongoing basis. Much like the original guilds and today's building trade unions' training programs, staffing agencies will assume the lead role for training their represented workers. No longer will companies have, or accept, the obligation to train workers. Instead, acquiring and maintaining appropriate skill sets will become a primary responsibility for each worker and training will be provided by his or her staffing agency. Such training must include all training required on employment and labor laws. Undoubtedly, staffing agencies will resist accepting responsibility for training workers as providing such training is an indicia of employee status.

2. Tax Interests and Government Pressures

Both federal and state governments have an interest in maintaining centralized and frequent collection of income and other taxes. A great deal of the tax revenue that funds ongoing government functions (apart from the debt) comes from employer collected income taxes. So government has an ongoing interest in increasing and speeding up the income tax collection process. So it is and will continue to be resistant to and closely scrutinize independent contractor relationships, which slow the transference of taxes from pay period to quarterly. Furthermore, governments have an often stated purpose of providing safety nets. From an employment perspective the principal safety nets are unemployment and workers' compensation and in a handful of states, state-funded disability programs. Unemployment and disability tax revenue are expressly earmarked into funds used for this purpose. Chronic and high unemployment has largely drained state unemployment insurance (UI) funds and most states are borrowing from the federal government to meet benefit needs.

Self-employed workers' income is not subject to UI taxes, but such workers, when they cannot find self-employed work, often try to re-characterize themselves as having been employees, rather than contingent workers. Thus, accepting a former employee as a contractor only plays with fire. Having no history as being self-employed coupled with returning to the company and the same work environment, albeit in somewhat more limited capacity, will likely result in a finding that the worker is an employee and not a contractor. In fact, we have developed a set of "Golden Rules" for this purpose, which should be applied objectively when evaluating the engagement of contractors:

- *Do not* be the first to engage a contractor.
- *Do not* accept a former employee as a contractor.
- *Do not* convert a contractor to an employee.

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- *Do not* engage a contractor to perform work already being done by an employee.
- *Do not* engage one with a recent history of employment elsewhere.

Of course, in states where there are income taxes, withholding at the source by employers is a quick way of keeping the state's income tax coffers restocked. The severe drain on social services and state resources by the current economic climate is likely to make the rebuilding climate susceptible to both higher taxes and new laws that will further discourage the engagement of the self-employed or otherwise require income tax withholding by companies that owe fees for services and goods provided by nonemployees. As the economy emerges from the current conditions, an increasing desire to engage contingent workers can be anticipated but this will statutorily compete with other pressures to have such individuals be employees of some "employer" rather than freelancers.

The majority of states currently use a statutory rather than common law test for determining employment or independent contractor status. It is anticipated that more states will adopt statutory tests, often a version of the ABC test, which makes it very difficult to establish an independent contractor relationship. This may simplify contractor status determinations, but increase the UI tax revenue from such determinations.

Staffing entities that provide for services that evaluate "employment status" of workers and payroll may be forced by new laws to simply become the employer of all workers that they provide rather than act as referral agencies or intermediaries, except under rare and stringent circumstances. As the purveyors of such workers, these companies' capitalization and capacity to timely meet tax obligations is likely to be of heightened concern and state laws aimed at regulating PEOs are likely to be expanded to extend to all staffing agencies and/or co-liability will be legislated, at least at the state level. Companies seeking these just in time services will need to be equally concerned with the ability of an agency to provide qualified staff but also its financial responsibility to meet the payroll tax obligations of an employer.

3. SUTA Dumping

Another emerging issue will probably also play out further with the restructuring during downsizing and future reorganizations and rebuilding and that is the primarily state-level concern about SUTA Dumping (SUTA stands for State Unemployment Tax Act). Unemployment insurance is really the product of federal law with its administration delegated to the states for administration.[67]

In 2004, the DOL, through a federal law, pressured states to enact laws, largely formulaic, which have had the impact of consolidating related employers into a single UI account for each state. The stated purpose was to prevent rate manipulation by employers transferring employees around to minimize adverse UI claims experience. The consequence is that states are trying to both fold related employers into a single account and are increasingly resistant to related employers establishing separate accounts. Consequently, when employers reorganize and consolidate or separate for legitimate organizational purposes, the states will at least try to block such measures. With the move of workers to PEOs or staffing agencies as a way of controlling costs, states are planning legislation and litigation to require such new employers to pay at the using companies rates. For example, Company A that acquires workers from unrelated Company X, may find that Company X must pay UI taxes at and through Company A. Although this approach is extremely difficult to administer, a company up-staffing for a recovering economy will likely be faced with this more socialized approach to such taxes. The long-term impact of these SUTA Dumping laws is to push labor into a single pool related to the entity using the services.

So, while entities are seeking just in time and contingent workers with fluidity to shift from project/company to company, the governments' needs for income tax and dedicated funds' revenue (SDI, UI, FICA) will be pressing for less flexibility. At this time, the widespread dismissal and furloughing of workers has over-extended all UI funding sources. These overstretched resources are already encouraging both states and the federal government to increase future wage bases (upon which such taxes are calculated). For example, currently California and the federal government use the historically low wage base of $7,000 for taxing UI/FUTA purposes, however, California has a bill pending that would raise the base to $16,000 in 2009, an increase of more than 100%! Thus, the adverse UI experience will likely significantly increase future tax rates. In the end, while companies have been quick to divest themselves of workers or trim their work weeks, the long term price that all will pay will come in the form of higher taxes, much higher taxes.

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4. Practical Steps to Take Today

- Identify the resources and skills that will be needed under the new model, determine where to procure such talent and contract with staffing agencies that can meet your needs.
- Require that staffing agencies provide all mandated training, including training required for employment and labor law purposes.
- Prepare to treat workers as contract labor, rather than employees.

K. Health Insurance

1. Likely Effect of Pending Health Care Proposals

Current health care proposals could accelerate the trend to smaller, more decentralized business organizations and independent contractors, by imposing rules making health care more available to this model of doing business. The Obama Administration has proposed a "National Health Insurance Exchange," which will offer private health plans and a public plan that will allow individuals and small businesses to purchase health coverage on a small group or individual basis.[68] Separately, as of February 5, 2009, thirteen Senators have co-sponsored the "Healthy Americans Act" (S. 391), which would require all adult residents of the United States to purchase health insurance from approved private insurers or employer-provided plans providing coverage at least to the level that is provided to federal employees. Premium costs would be subsidized by the government for individuals below 100% of the federal poverty level.

Either the President's proposal or S. 391, if enacted, would have the effect of uncoupling, for the first time since World War II, the virtually exclusive connection between employment and the delivery of health care coverage to the American workforce.

Under the current system of employment-based health coverage, many employers and employees report the phenomenon of workers who remain employed, as opposed to working as free-lance independent contractors, because of the practical requirement of health insurance coverage. For various reasons, (having children in the home, or a family member with health issues) many workers in America seek employment primarily because it offers health coverage. The existence of a non-employment based health coverage alternative to private working individuals would arguably free those individuals to leave the constraints of a full-time employment environment for more entrepreneurial pursuits. At a minimum, the de-coupling effect would offer affordable alternative health care and remove the present obstacle to individual workers being able to work out of home-offices and shops around the country.

In addition to government-based health care delivery, a vehicle already available under the existing structure may come to the forefront as the workforce evolves to a smaller organizational structure.

2. Risk-Pooling: The Key to the Small Organization Concept

Apart from the prospect of a system of national health coverage, either under the President's proposal, or one based on the S. 391 model, a key issue of the delivery of health care to workers and their dependants in the new emerging environment will be how to leverage large organization risk-pooling of health costs in the small company/individual contractor environment.

At the heart of the modern health care delivery system is the concept of risk-pooling, in which the risk of catastrophic illness is spread across a large population of individuals. With the dramatic increase in health care costs and inflation over the past 25 years, smaller employers and self-employed individuals have found themselves at a distinct disadvantage competitively because of the impact of the small (or nonexistent) risk pool.

For example, a large organization with thousands of employees can take advantage of a large risk pool by maintaining a self-insured health plan backed up by stop-loss insurance (which insures the employer, not the employee, as in a fully-insured health plan). The self-insured plan is not subject to state insurance law minimum coverage mandates, and therefore delivers superior health coverage at a lower cost. However, the smaller the organization, the less practical this arrangement becomes because of the risks inherent in a small group, where a single premature baby, multiple coronary bypass surgery or cerebral hemorrhage can impose crushing liabilities on a plan covering only a few participants. In such a situation, the small organization can find it's health insurance, or stop loss coverage, increase dramatically in the years following the catastrophic claim.

This disparity in the effect of risk-pooling between small and larger employers is evident in the fact that smaller companies (2 – 199 employees) are half as likely to offer health coverage

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as larger employers (200 and more employees), and among those that offer such coverage, small employers shift a greater burden of cost-sharing, in the form of higher deductibles and co-pays, to their employees in order to keep premiums reasonably competitive with those paid by employees in larger firms.[69]

3. Risk-Pooling and ERISA

ERISA[70] generally was intended to provide a regulatory scheme for employee benefit plans established by an employer (including a group of employers affiliated through common ownership), for the exclusive benefit of its employees or an employee organization. Title I of ERISA does not apply at all to a plan that covers only owners of the company and their dependents. ERISA contains an internal bias in favor of larger employer and union-sponsored plans, particularly in the self-insured environment, through the approval of union-sponsored multi-employer plans and the restrictions on multiple employer welfare arrangements (MEWAs).[71]

The MEWA is a welfare arrangement covering the employees of two or more employers that are not members of the same control group. A MEWA may be an ERISA-covered employee benefit plan, or it may not be covered by ERISA at all. The ERISA-covered MEWA generally is a plan established by "a bona fide group or association of employers" that have some common business interest, such as an association of employers in the same industry.[72] MEWAs come in two flavors, self-insured, and fully insured. Under ERISA, a self-insured MEWA is subject to ERISA's regulatory requirements, but is also subject to state insurance law regulation to the extent such laws do not conflict with ERISA — therefore the self-insured MEWA is regulated by both ERISA and state insurance regulatory agencies.[73] Most state insurance regulatory bodies view the self-insured MEWA as an unlicensed insurance company, and in some states they are prohibited altogether. The MEWA rules, coupled with restrictive state insurance laws, effectively serve as a barrier to the formation of self-insured MEWA's that could effectively permit the pooling of a large number of smaller companies and individuals into large pools and permit effective reduction of health care costs.

However, if the MEWA is "fully insured," that is, if benefits under the MEWA are fully and directly guaranteed by an insurance policy or contract issued by a company that is qualified to do business in each state in which the MEWA provides benefits, then ERISA preemption applies, and the MEWA itself is not otherwise subject to state regulation.[74] A fully-insured MEWA may be an effective way for an association of employers and self-employed individuals to purchase health insurance through a larger risk pool than would otherwise be possible.

In the absence of Congressional action easing the restrictions on self-insured MEWAs, which does not appear to be forthcoming, creative navigation of the existing MEWA rules might still permit small organizations, through trade, professional and commercial associations, to leverage the power of the larger organization without having to incur the organizational downside of such a structure. It will be a significant challenge to the growth of the MEWA structure that, while ERISA at least accounts for the existence of the MEWA and provides a statutory scheme, its history has been clouded by unfortunate instances of poor, and in some cases fraudulent, practices by MEWA providers. These instances have caused the MEWA to become an enforcement priority for both the DOL and state insurance regulatory agencies.

However, this does not mean that competent and ethical MEWA operators may not in the future be able to meet the challenge posed by this pending seismic shift in the nature of the delivery of labor. Thus, there may yet be significant opportunities simultaneously for substantial cost savings and delivery of quality health coverage for workers who are a part of the movement to small organizations, and their families, through the MEWA vehicle. Just as the PEO movement was troubled, early in its history, with unsavory operators, after a period of reform, ethical and effective PEO providers entered the market, and the PEO industry became a substantial and thriving one. Indeed, currently, one of the most significant examples of penetration of the MEWA in the health plan market appears to be in the area of franchising, for example, where a franchisor sponsors a MEWA to provide health benefits to its unaffiliated franchisees.[75] Creative and ethical MEWA operators may be able to achieve a similar success with the coming revolution in the American workplace.

4. Practical Steps to Take Today

- As the federal government sorts out national health care coverage, companies should conduct a serious examination of their health insurance plans and consider reducing benefits (to prepare for national coverage) and offset the reduction with increases in other types of benefits or compensation.

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- Review plan terms such as employee and dependent eligibility provisions to ensure that coverage is extended only to those specific classes of employee/dependent as permitted under the plan. Do not permit independent contractors and nonemployee directors to be covered under your plan.
- Avoid unintentionally establishing or becoming part of a MEWA. For example, do not allow a corporate merger, acquisition or divestiture to result in coverage under any employee benefit plan of the employees of an entity that does not qualify as part of the control group of the plan sponsor.
- Be sure your plan language clearly provides that only employees of members of the employer's control group may be covered under your plans, and provide protective language that the plan is deemed to be separately adopted as a single employer plan in case the employees of any unaffiliated employer are inadvertently covered under it.

L. Retirement Benefits

1. What Will the Future Hold

Retirement plan design is expected to take a major shift as the economy moves to meet the needs of the new workforce. Compensation programs that reward longevity and provide equal benefits regardless of individual skill and performance will no longer support companies' needs. Dollars previously invested in retirement plans will be redirected to other parts of the compensation package, particularly incentive pay.

2. Reduce or Eliminate Retirement Plan Benefits

Currently, many companies maintain retirement plans for their employees, however, no such benefits are permitted to be made to nonemployees such as independent contractors or workers on third-party payrolls. And often firms will also exclude employees who are classified as "project workers", temporary employees and seasonal employees. As is further discussed below, this has led to many situations where a contingent worker may feel that he or she is doing the same job as a benefits-eligible employee. This, in turn, has led to lawsuits where these workers claim benefits on account of being "misclassified". Businesses who want to encourage contingent workers will attempt to limit this disparity, however, due to the inappropriateness of retirement benefits for contingent workers, we are likely to see the field being leveled by reductions or eliminations of the retirement benefits currently in place for "regular" employees. Where retirement benefits are not eliminated, suggestions for how they may change are included below.

3. Reduce 401(k) Matching Contributions

A 401(k) plan is not required to provide matching contributions. Moreover, matching contributions can be reduced or eliminated, as long as the plan satisfies nondiscrimination tests and appropriately limits the amount of contributions. A change in the formula is permitted, so long as the change is prospective. During the economic downturn, many plan sponsors reduced or eliminated matching contributions. As plan sponsors recover from the downturn and rebuild, plan sponsors may choose to keep the reduced matching contribution formulas and redirect funds to other aspects of the compensation package. As an alternative, certain companies will substitute the current model of a "promised" fixed matching contribution rate with a more flexible discretionary structure so that workers view this benefit not as an entitlement but rather as a variable reward tied to company performance.

4. Reconsider Vesting Schedules

Firms are permitted to implement a vesting schedule, requiring participants to complete a specified number of years of service, within Internal Revenue Code limits, before most types of employer contributions become non-forfeitable. (Employee contributions always are 100% vested.) Forfeitures generally can be used to reduce employer contributions for the next plan year or paying certain permitted administrative expenses. Historically, many employers used the longest vesting schedules permitted by law, viewing these schedules as handcuffs that would retain employees for an indefinite time period. When building the new workforce, however, plan sponsors will need to evaluate the amount of time workers are needed and tailor vesting schedules to meet the desired timeframe. Companies must choose whether to shorten or even eliminate the vesting schedule — to attract and retain key talent, who may not intend to be employed for the duration of the vesting schedule — or keep longer vesting schedules, so that the plan sponsor can recapture forfeitures and redirect funds that would have been used for the next year's contributions or administrative expenses. In a departure from present practice, companies may provide shorter vesting schedules for rank and file employees who are part of a flexible

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workforce and longer schedules for executives who may be needed for a longer timeframe.

5. Redesign Profit-Sharing Contribution to be Discretionary and Eliminate Fixed Money Purchase Contributions

In an effort to maintain flexibility when the economy recovers, companies will redesign not only their matching contributions but also profit-sharing and money purchase contributions. This is in line with a general trend of keeping all benefits as flexible as possible.

6. Continue the Transition from Defined Benefit to Defined Contribution Plans

Companies will continue to move away from defined benefit programs to defined contribution (generally, 401(k)) plans. In the new workforce, firms may find that traditional retirement programs — where eligibility is determined on broad-based eligibility criteria and which reward longevity — no longer make sense. Moreover, plan sponsors will want to avoid the unpredictable (and increasingly enormous) liabilities associated with defined benefit plans. The members of the new workforce who are eligible for retirement benefits may appreciate the portability of defined contribution retirement programs. Companies that have maintained defined benefit plans may transition the plans to cash balance plans, which have many of the same characteristics as defined contribution plans. A *cash balance plan* is a defined benefit plan to which the company makes a contribution each year, that defines the promised benefit in terms of a stated account balance. Although cash balance plans were challenged in the courts on age discrimination and other grounds, the Pension Protection Act of 2006 and regulations issued by the Internal Revenue Service now make them a viable option.

7. Review Current Plan Eligibility Criteria and Administrative Practice to Best Immunize the Plan Sponsor from Eligibility-Based Lawsuits

With the new workforce, plan sponsors may reconsider whether they wish to exclude temporary and seasonal employees, as well as "project" workers. Some firms with large contingent workforces may wish to put all employees on the same playing field. This may cause a loosening of plan eligibility rules and an insistence that those who are paid by a third party (who are barred by law from receiving retirement benefits provided to employees) be provided comparable benefits by the third party. For organizations that wish to continue to exclude all contingent workers from their retirement benefits, there will be much tighter eligibility criteria than currently seen in many retirement plans. This will entail more precise wording in the eligibility provisions of retirement plans and precise and workable definitions, which are used in the workplace to distinguish different types of workers. For example, there are plans today that exclude classes of employees, such as "casual employees" or "project" workers whose jobs may look no different than a regular employee. Such criteria could be viewed by the Internal Revenue Service, DOL or a court, in a lawsuit brought by employees, as a sham attempt to save money on benefits. Therefore, companies must redouble their efforts to build real work-related distinctions into the classifications of employees who are or are not eligible to participate in a retirement plan.

8. Redouble Efforts to Exclude from Participation Individuals Whom the Plan Sponsor Believes Are Independent Contractors, But Are Later Reclassified by a Governmental Entity as Common Law Employees

When the new workforce is rebuilt, companies will want to make sure that only those individuals whom it wishes to be eligible are eligible to participate in its retirement plans. In particular, businesses will want to make sure that plan documents and summary plan descriptions clearly exclude from eligibility independent contractors, individuals employed by temporary and staffing agencies (including those jointly employed with temporary/staffing agencies), and independent contractors reclassified by a government entity as employees. Although the general rule is that only common-law employees may participate in a 401(k) plan, it is not always clear which individuals are common-law employees. A company's determination, and the IRS's determination, of who is a common law employee may differ; in such case, it is important that the plan document exclude "reclassified" employees from eligibility. Businesses have paid close attention to this issue since the Ninth Circuit Court of Appeals issued its decision in *Vizcaino v. Microsoft Corp.*,[76] which held that certain Microsoft workers who were originally hired as independent contractors, and later reclassified by the Internal Revenue Service as employees, were entitled to benefits under Microsoft's 401(k) plan and employee stock purchase plan. By redoubling efforts in this regard, companies can structure their retirement plans defensively to guard against future unwanted claims for benefits eligibility. Additionally, contingent workers

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should always be asked to sign waivers in which they expressly disclaim any entitlement to benefits.

Close examination of the length of time that workers are retained is also warranted. Benefit costs can be saved if, for example, workers will not be employed for more than 1000 hours per year and the plan contains a rule requiring at least 1000 hours of service prior to accruing a benefit.

9. Expand Opportunity for 401(k) Rollovers

Plans may, but are not required to, accept eligible rollover distributions from eligible retirement plans, such as 401(k) plans, 403(b) plans, and 457 plans, and some after-tax and Roth contributions. Members of the new workforce —who will move between companies more frequently — may wish to consolidate their retirement funds through rollover to the new company's plan. Notably, a plan can authorize acceptance of rollovers for those who would not otherwise qualify as eligible participants — so a 401(k) plan generally could implement maximum service requirements for purposes of deferrals and matching contributions, if any, but still allow new workers to rollover funds from prior plans. Rollovers, while an administrative burden to administer, have the advantage of increasing assets in the plan, which can reduce overall fees and expenses.

10. Practical Steps to Take Today

- Plan to reduce employer-provided retirement benefits, whether it is matching contributions, profit sharing or defined benefit plan accruals, in favor of benefits that the current workforce desires. Make a reallocation of resources in favor of incentive compensation over retirement plan accruals.
- Encourage contractual arrangements whereby retirement benefits flow from the staffing agency to enhance the benefit of being with a staffing agency and reduce the impulse to claim common law employee status.
- Plan eligibility criteria should be reviewed. Existing plan language should be tightened to best assure that those who are not employees do not get benefits. And all companies should make certain that in the event of worker reclassification, those who are excluded from coverage have no claim on benefits.
- Traditional defined benefit pension plans will become even less popular than they are today with their huge and highly variable cost structures. Instead, move toward a more predictable means of providing retirement plan benefits. Cash balance plans can replace some defined benefit plans, or simply freeze benefit levels with no additional benefit plan to take its place.

III. TWELVE PRACTICAL RECOMMENDATIONS TO IMPLEMENT TODAY IN ANTICIPATION OF THE NEW WORKFORCE

Below are twelve practical recommendations to overcome the employment and labor law challenges of the coming new workforce. Littler predicts that when the recession ends (potentially as early as the 4th Quarter 2009), 50% or more of the new workers joining business organizations as they rebuild will be contingent workers. Contingent workers are given a very expansive definition in this Report. They include contingent workers retained directly by the employer or arriving through staffing agencies or other organizations such as PEOs. Also included is the vast numbers of temporary workers including those with flexible or non-traditional work schedules. Of course the term also includes independent contractors and business consultants with the recognition that the IRS and other branches of government will set a high standard for independent contractor status given the fear that such workers present a tax enforcement challenge.

Before listing specific practical recommendations, it is critical to note that often parts of the contingent workforce are invisible to top management. This is understandable as many of these relationships evolved from vendor contracts that provided goods and supplies, but also services often delivered with on-site personnel. It is essential that the full contingent workforce become visible and that a compliance commitment is made at the highest levels of the organization with adequate resources to ensure it is accomplished. The following mandate is necessary to bring to life the many practical and specific recommendations provided below.

Mandate: Increase the Visibility of the Contingent Workforce and Make a Compliance Commitment.

One: Conduct a Compliance Audit to Prepare for the New Workforce and the Coming Enhanced Government Enforcement of Employment and Labor Law.

- Identify current contingent workers and the likelihood of growth in this workforce in your particular organization.

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- Assess your current level of employment and labor law compliance recognizing the differences between the various sectors of your workforce (regular employees, flex-workers, contingent workers, temps, independent contractors, and others).
- Recognize the coming enhanced enforcement efforts including 250 additional DOL inspectors, $600 million more to enforce wage and hour laws, expanded workplace safety enforcement, and new regulations and enforcement initiatives regarding antidiscrimination law.
- See the Compliance Section of the Report, above at Part II, outlining the special role of contingent workers under the various employment and labor statutes.
- Consider making the audit and recommended improvements attorney-client privileged in anticipation of litigation.

Two: Consider the Appointment of a New Workforce Compliance Specialist: A Professional Responsible for Becoming an Expert on Employment and Labor Law Compliance for the Contingent Workforce.

- The application of current and proposed laws and regulations to the contingent workforce will involve complexity and uncertainty. This is supported by a quick review of the areas of law surveyed in this Report.
- The New Workforce Compliance Specialist will facilitate business plans to add contingent workers while keeping a focus on compliance in a new world of government enforcement of employment and labor laws.
- Define the reporting responsibility of this professional between Legal, HR, and Procurement. In many ways this professional can link resources from all three areas into a single force.

Three: Immediately Source or Pre-Source Contingent Worker Providers and Negotiate Key Provisions of the Vendor Contracts to Facilitate Employment and Labor Law Compliance.

- Staffing agencies and other providers of contingent workers will be on overload as the economy recovers. Sourcing specialized resources now will give your organization priority.
- With a majority of contingent workers being skilled, learn how the new professionals can be located and retained. Even if your organization has no current need, pre-source these resources.
- Negotiate key compliance requirements in your agreements including necessary background checks, safety requirements, antidiscrimination pledges and procedures, including recordkeeping and wage and hour requirements.
- Give special attention to the November 1, 2008, Federal Sentencing Guidelines and how the Guidelines require enterprise-wide compliance with qualifying codes of conduct and necessary training. Ensure that these new requirements are part of your contingent workforce agreements.

Four: Consider the Establishment of a Pilot Global Mobility Program if One Does Not Exist Within Your Organization.

- Few organizations in a post-recession economy will be able to adequately staff their required new workforce without considering global resources.
- Pre-identify how talent and resources can be quickly accessed worldwide. Learn what is available.
- Consider how to establish a low cost subsidiary outside the U.S. that can facilitate cross-boarder work authorizations.
- Organizations who do their homework now and make minimal investments will be ahead of competitors by six to eighteen months when the talent wars and outsourcing race begins.

Five: Review and If Necessary Revise Privacy Protocols to Match the New Workforce Requirements.

- In the struggle to have an effective contingent workforce and avoid joint employer status, workplace privacy policies and practices need review and probably revision.
- How much information can be required from nonemployees who have virtual or actual access to the workplace? How can an organization confirm that necessary background checks have been conducted?
- What privacy expectations exist concerning monitoring of nonemployee contingent workers?
- How do Web 2.0 policies impact employees differently from contingent workers?

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- This is a classic area to be covered in a compliance audit and can draw upon the special expertise of your appointed new workforce professional.

Six: Ensure Wage and Hour Compliance by Third-Party Contractors, Vendors, and Other Contractors.

- The largest dollar risk in the workplace comes from the class action wage and hour epidemic. *Total Wage and Hour Compliance* (Littler Report 2008 Initiative)[77] is mandatory in the Age of Obama.
- The enterprise business and "economic realities" tests put organizations at risk for the wage and hour compliance of the entire new workforce (including many of the nonemployees in the contingent workforce).
- Ensure that contracts with vendors, third-party contractors, and staffing organization include wage and hour compliance mandates and indemnification language.
- Consider using a third-party certification agents and "blind" audits to provide extra evidence of compliance.
- Make sure the business terms are considered in evaluating compliance. Contracts that are so economically favorable that they make wage and hour compliance impossible (or highly unlikely), may be held to provide constructive notice of noncompliance.

Seven: Review Executive Compensation Agreements and Practices for Their Impact on the New Workforce.

- The rapidly changing work environment and business combinations may mandate major changes in executive selection, retention, and assignments. Minimize the economic penalties in executive compensation agreements for such needed changes.
- Monitor the flood of government executive compensation limitations and requirements that may be impacted by the growing new workforce.
- Examine how the new workforce may impact deferred compensation agreements and nondiscrimination tests.
- Consider opening certain executive compensation programs to nonemployee consultants and independent contractors.

Eight: Monitor and Avoid Traditional Labor Law Landmines Associated with the Arrival of the New Workforce.

- Employers with collective bargaining agreements need to immediately review provisions that could greatly limit the use of the new workforce. A collective bargaining agreement with an anti-subcontracting provision or even silence on this subject could prevent the necessary use of contingent workers.
- Anticipate that the Obama-appointed National Labor Relations Board may again include contingent workers in bargaining units with regular employees. Examine areas where a potential community of interest exists between the two workforces and consider possible changes.
- Consider the impact of a unionized workforce arriving in the form of contingent workers and what responses may be necessary.
- Consider the implications of the Employee Free Choice Act or similar legislation on organizing the contingent workforce and the role online social networks may play in providing preventive education.

Nine: Protecting Trade Secrets and Enforcing Covenants Not-to-Compete Within the New Workforce.

- Review, and as necessary modify, invention and proprietary information agreements with staffing agencies, contractors, and nonemployee individuals.
- Review and modify information access rules including identifying and marking confidential proprietary information.
- Control computer access and modify as needed downloading protocols.
- Re-examine the value and enforceability of noncompete agreements in the context of a contingent workforce and changing judicial and legislative requirements and prohibitions.

Ten: Planning for Reductions in Force and Meeting WARN Requirements Within the New Workforce.

- The hallmark of the new workforce is flexibility and the ability to quickly adjust to changing business conditions. Learn and consider implementing conditions that would prevent coverage by WARN (federal and state).

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- Staffing agency employers need to understand and anticipate how their obligations could be impacted by abrupt business condition changes on the part of their clients.
- Establish expectations regarding future employment for contingent workers who are moving from project to project.

Eleven: Evaluate the Impact of the New Workforce on Workers' Compensation Coverage and Unemployment Insurance Taxes (as Well as Other Employment Taxes).

- Workers' compensation insurance costs and coverage will shift depending on the structure of the contingent workforce. Anticipate that limiting costs may expose the organization to civil litigation from injured contingent workers if workers' compensation pre-emption does not apply. Does your general liability insurance cover such situations?
- Determine which entities will be responsible for unemployment insurance and other taxes and factor this into revenue and expense decisions.

Twelve: Review and Revise Benefit Programs in Anticipation of the New Workforce.

- This is one of the most important practical aspects of preparing for the new workforce. Great change is coming and should be anticipated.
- Consider the future role of your organization in providing for health care insurance coverage and President Obama's pledge to have legislation passed by the end of 2009. Anticipate that your organization will likely have less of a role in providing medical insurance benefits as the contingent workforce expands.
- Consider the impact of MEWAs and make an informed decision regarding how it will impact your organization.
- Consider the reduced role of organizations in providing retirement benefits with the arrival of the contingent workforce. Examine your 401(k) program and the implications of the safe-harbor provision if your program has many highly compensated individuals.
- Evaluate the role of equity incentive programs with the new workforce and the threat of creating "common law" employees.

Bonus (A Thirteenth Practical Recommendation Included Within the Littler Dozen): Review Your Policies and Practices Concerning Flexible Employment Arrangements Involving the New Workforce.

- Employment laws are increasingly creating protection for workers who have or need flexible work schedules. Flexibility bias is one of the top concerns of the current Congress. Many existing laws and regulations provide protection for individuals and caregivers who require a flexible work schedule.
- The contingent workforce is staffed partly by individuals who value a flexible work schedule.
- Alleged gender bias is more often bias against part-time employment and flexible work arrangements. Policies and procedures should be reviewed to eliminate unjustified flexibility bias.
- Consider the business case for flexibility and whether this is a hallmark of the new workforce.

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ENDNOTES

1 Kristina Cooke, *Recession will be worst since 1930s: Greenspan*, Reuters (Feb. 18, 2009), *available at* http://www.reuters.com/article/ousiv/idUSTRE51H0OX20090218 (last accessed Apr. 20, 2009).

2 *See, e.g.*, Frank Ahrens, *Economists: Recession to End This Year, But Unemployment Will Hit Nearly 10%*, Wash. Post (Apr. 10, 2009), *available at* http://voices.washingtonpost. com/economy-watch/2009/04/economists_recession_to_end_th.html (according to Blue Chip Economic Indicators Survey, 86% of private economists believe recession will end in the second half of 2009).

3 As used herein, the term *contingent workers* or *contingent workforce* refers not only to those individuals holding temporary jobs. Rather, these terms are used broadly to refer to both the employees traditionally thought of as contingent, *and* all other workers having any form of alternative work arrangements. Thus, included in the predictions and trends are temporary employees, staffing agency employees, consultants, independent contractors, flexible/on-call workers, and all other forms of temporary or alternative work arrangements.

4 Littler has been following the MIT model for nearly a decade and previously referenced it in its 2004 Report on the Contingent Workforce. *See* Garry G. Mathiason, *et al.*, *Strategic Initiatives for the Changing Workforce*, Littler Report, at 20-22 (Apr. 2004) *available at* http://www.littler.com/PressPublications/Lists/Littler%20Reports/DispReport.aspx?id=20.

5 *See* Robert J. Laubacher & Thomas W. Malone, *Two Scenarios for 21st Century Organizations: Shifting Networks of Small Firms or All-Encompassing "Virtual Countries,"* MIT Initiative on Inventing the Organizations of the 21st Century, Working Paper # 001 (Jan. 1997), *available at* http://ccs.mit.edu/21c/21cwpmain.html.

6 *See* Robert J. Laubacher & Thomas W. Malone, *Flexible Work Arrangements and 21st Century Workers' Guilds*, MIT Initiative on Inventing the Organizations of the 21st Century, Working Paper # 004 (Oct. 1997).

7 *Collaborative filtering* refers to online systems that profile consumer likes and dislikes and make recommendations based on those preferences. This system is already used today by some online companies, such as Netflix and Amazon.

8 Staffing Industry Analysts, Inc. (SIA) is the premier research and analysis firm covering the contingent workforce. Known for its independent and objective insights, the company's proprietary research, data, support tools, publications, and executive conferences provide a competitive edge to decisionmakers who supply and buy temporary staffing. In addition to temporary staffing, SIA also covers these related staffing service sectors: third-party placement, outplacement, and staff leasing (PEOs).

9 Ron Mester has been SIA's Managing Director since early 2002. The company has grown substantially in that time. Ron spent eleven years of his career with Towers Perrin, one of the world's ten largest consulting firms, where he advised Fortune 1000 companies in more than a dozen industries on human capital strategy, organizational effectiveness, and overall business strategy. Ron left Towers Perrin to become Executive VP of Sales and Marketing at MarketTools, a start-up providing web-based market research services, where among other things he originated and developed the concept for Zoomerang, which is today the world's top source of online surveys. He then served as President and CEO at Decise, a start-up delivering web-based market/competitive intelligence, before taking on his current role. Ron holds an M.B.A. from the Wharton School and a B.A. from U.C. Berkeley.

10 *Large companies* refer to companies having 1,000 or more employees.

11 Charts provided to Littler by SIA, which show the statistics used herein, are included in Appendix A. See also Dr. John Sullivan & Master Burnett, *Managing Contingent Labor Strategically*, (Mar. 15, 2009), *available at* http://www.ere.net/2009/03/15/managing-contingent-labor-strategically/ (work allocated to contingent labor has grown from 6% in 1989 to more than 27% in 2009; according to study completed in January 2009 by the Aberdeen Group, a majority of employers expect their use of contingent labor to increase in the next two years, with 10% of employers expecting a "significant growth."); Elizabeth Rice, *Contingent Workforce Management: Best Practices*, (Jan. 3. 2009), *available at* http://www.articlesbase.com/management-articles/contingent-workforce-management-best-practices-707059.html

12 *Bad Year for Job Losses*, Contingent Workforce Strategies Magazine, at 8 (Jan/Feb 2009).

13 U.S. Dep't of Labor, Bureau of Labor Statistics, *Contingent and Alternative Employment Arrangements*, Feb. 2005, *available at* http://www.bls.gov/news.release/conemp.nr0.htm.

14 HR Institute, *The Future of Work—2015*, Canadian Management Centre Special Rep., at 7 (Sept. 2005).

15 *See* http://twitter.com/ (last accessed Apr. 21, 2009).

16 *See* http://www.linkedin.com/ (last accessed Apr. 21, 2009).

17 *See* https://www.rypple.com/about.shtml (last accessed Apr. 21, 2009); *The Rypple Effect*, The Economist (Dec. 30, 2008).

18 Matthew Fraser & Soumitra Dutta, *Barack Obama and the Facebook Election*, U.S. News & World Rep. (Nov. 19, 2008). A co-founder of Facebook was one of President Obama's key strategists. Masterminding a "highly effective Web blitzkrieg" resulted in Obama winning nearly 70% of the vote among Americans under age 25, the highest percentage of that age group won by any U.S. presidential candidate since exit polling began in 1976. President Obama's use of "virtual networks" for campaigning is now being taken to new levels by other politicians. For example, San Francisco Mayor Gavin Newsom recently announced online his candidacy for Governor of California. In what his advisers call a "new media-based campaign," Newsom is targeting technology-savvy young voters on Twitter and Facebook, where he has already garnered 270,000 and 40,000 followers respectively. Carla Marinucci, *Newsom Makes his Official Governor Bid Online,*" S.F. Chron. (Apr. 21, 2009), *available at* http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/04/21/MNJO175RRK.DTL&tsp=1.

19 Amanda Lehnart, *Adults and Social Network Websites*, Pew Internet & American Life Project (Jan. 14, 2009), *available at* http://www.pewinternet.org/Reports/2009/Adults-and-Social-Network-Websites.aspx; *see also* Amanda Lehnart & Susannah Fox, *Twitter and Status Updating*, Pew Internet & American Life Project (Feb. 12, 2009), *available at* http://www.pewinternet.org/Reports/2009/Twitter-and-status-updating.aspx. According to the latter report, 11% of online American adults have used Twitter or another online service that allows users to share status updates. Users of these services also tend to be more mobile. Rather than accessing the Internet at home or work, these users tend in greater numbers to rely on laptops, blackberries, cell phones, and other wireless devices to access the Internet and participate in online social networking.

20 U.S. Dep't of Labor, Bureau of Labor Statistics, *Contingent and Alternative Employment Arrangements*, (Feb. 2005), *available at* http://www.bls.gov/news.release/conemp.nr0.htm.

21 HR Institute, *The Future of Work—2015*, Canadian Management Centre Special Report, at 9 (Sept. 2005).

22 Dan Hanyzewski, Talent Link: A Brave New Breed, CONTINGENT WORKFORCE STRATEGIES, (Jan/Feb 2009).

23 U.S. Dep't of Labor, Bureau of Labor Statistics, *Contingent and Alternative Employment Arrangements*, (Feb. 2005), *available at* http://www.bls.gov/news.release/conemp. nr0.htm.

24 A universe of research and reports exist regarding the transformation of the workforce. It is not Littler's role to recreate that work or do more than provide a mere sample. For more comprehensive treatment of the coming contingent workforce please see *Contingent Workforce Strategies Sourcebook* published by Staffing Industry Analysts, Inc. (2008). An early prediction of the employment model that is now being forecast for 2010 is Daniel H. Pink's *Free Agent Nation: The Future of Working for Yourself* (Warner Business Books 2002).

25 U.S. Dep't of Labor, Bureau of Labor Statistics, *Number of Jobs Held, Labor Market Activity, and Earnings Growth Among the Youngest Baby Boomers: Results From a Longitudinal Survey Summary*, (June 27, 2008). This survey focused on individuals born between the years 1946 and 1964. Some studies indicate that more recent generations are changing jobs and careers even more quickly. *See, e.g.*, Dan Hanyzewski (staffing director for Nike), *Talent Link: A Brave New Breed*, Contingent Workforce Strategies, (Jan/Feb 2009) (Per Bruce Tulgan, founder of generational-research firm Rainmaker Thinking, members of the "high maintenance" and "high-performing" "Generation Y" "don't like to stay too long on any one assignment"); Anne Fisher, *What do Gen Xers Want?*, Fortune (Jan. 20, 2006) (average employee in late 20s has already changed jobs 5 or 6 times), *available at* http://money.cnn.com/2006/01/17/news/companies/ bestcos_genx/.

26 *See* Benjamin J. Romano, *Microsoft Work Force Includes About 80,000 Vendors, Temps*, Seattle Times (Mar. 4, 2009), *available at* http://seattletimes.nwsource.com/html/microsoft/ 2008808755_msfttemps04.html?syndication=rss.

27 *Id.*

28 *See* Subadhra R. Sriram, *And Compliance for All*, Workforce Strategies Magazine, (Mar./Apr. 2009) (profile of Cisco's use of contingent workers); Subadhra R. Sriram, *Programmed to Succeed*, Contingent Workforce Strategies Magazine, (Jan/Feb 2009) (profile of 3M's contingent workforce management program).

29 *Joint employers* are separate and distinct entities that exercise some control over the work and working conditions of the same employee(s).

30 The general exception to this primary/secondary employer analysis under the FMLA applies to those employees who have worked for at least one year at the secondary employer's facility, in which case the employee's primary worksite is that location.

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31 A PEO performs solely administrative functions for its clients, such as payroll, benefits, regulatory paperwork, and updating employment policies.

32 Specifically, the FCPA applies to any companies issuing securities registered with the Securities and Exchange Commission (SEC) under Section 13 of the Securities Exchange Act of 1934 (the "Act") or filing reports with the SEC under Section 15(d) of the Act, any other entities organized under U.S. law or having a principal place of business in the U.S., or any U.S. citizen, national or resident, any U.S. or foreign agent of these entities.

33 *See Vondriska v. Paychex Bus. Solutions, Inc.*, No. 8:07-CV-1322-T-24-TGW, 2009 WL 632889, at *7 (M.D. Fla. Mar. 11, 2009). The U.S. Department of Labor has provided the following factors as relevant to the determination of joint employment status: (1) the power to control or supervise the workers or the work performed; (2) the power, whether alone or jointly or directly or indirectly, to hire or fire or modify the employment conditions of the individual; (3) the degree of permanency and duration of the relationship; (4) the level of skill involved; (5) whether the activities the workers perform are an integral part of the overall business operations; (6) where the work is performed and whose equipment is used; and (7) who performs payroll and similar functions. WH Opinion Letter, 2001 WL 1558966 (May 11, 2001).

34 *See, e.g., Abraham v. Singh*, 480 F.3d 351 (5th Cir. 2007) (remanding RICO claim by immigrant workers alleging violations associated with H2B visas).

35 *See Sullivan v. Oracle Corp.*, 547 F.3d 1177, 1187 (9th Cir. 2008) (applying California wage laws to employees performing minimal work in the state), *superseded by* 557 F.3d 979 (2009) (withdrawing panel opinion and certifying questions to California Supreme Court).

36 This portion of the Report does not contemplate a fully independent contractor for services, as that model already exists, for example, in the form of a private law firm or an independent accounting firm.

37 331 NLRB 1298 (2000).

38 343 NLRB No. 76 (2004).

39 Ponemon Institute, *Data Loss Risks During Downsizing* (Feb. 23, 2009), *available at* http://scm.symantec.com/DLP/tw/resources/extra_pdfs/Data_Loss_Risks_During_Downsizing.pdf.

40 U.S. Dep't of Labor Press Release Number: 09-0364-NAT, *available at* http://www.dol.gov/opa/media/press/opa/OPA20090364.htm (visited Apr. 6, 2009).

41 29 U.S.C. §§ 2101 2109.

42 In September 2003, the federal Government Accounting Office issued a lengthy report highly critical of the confusion created by the WARN statute and implementing regulations. *See* U.S. Gov't Accounting Office, The Worker Adjustment and Retraining Notification Act: Revising The Act and Educational Materials Could Clarify Employer Responsibilities And Employee Rights, GAO-03-1003 (Sept. 19, 2003).

43 20 C.F.R. § 639.3(a)(2) (emphasis added).

44 29 U.S.C. § 2101(a)(2), (3).

45 20 C.F.R. § 639.3(e). *See also Bradley v. Sequoyah Fuels Corp.*, 847 F. Supp. 863 (E.D. Okla. 1994) (agency temps are not affected employees entitled to notice).

46 29 U.S.C. § 2101(a)(5).

47 29 U.S.C. § 2101(b)(1). *See Alter v. SCM Office Supplies*, 906 F. Supp. 1243, 1248 (N.D. Ind. 1995).

48 *See* 54 Fed. Reg. 16,042, 16,048 (DOL).

49 *See, e.g., Headrick v. Rockwell Int'l Corp.*, 24 F.3d 1272 (10th Cir. 1994) (first contractor ceded to second contractor its rights under various leases, subleases, and accounts receivable, and second contractor absolved first contractor of responsibility for potentially substantial liabilities).

50 *International Oil, Chem. & Atomic Workers, Local 7-517 v. Uno-Ven Co.*, 170 F.3d 779. 784 (7th Cir. 1999).

51 *See McCaffrey v. Brobeck, Phleger & Harrison, L.L.P.*, No. C 03-2082 CW, 2004 U.S. Dist. LEXIS 2768, at *11 (N.D.Cal. 2004).

52 *Local 217 v. MHM, Inc.*, 976 F.2d 805, 808 (2d Cir. 1992).

53 *Teamsters v. American Delivery Serv. Co., Inc.*, 50 F.3d 770, 777 (9th Cir. 1995); *see also Halkias v. General Dynamics Corp.*, 137 F.3d 333 (5th Cir. 1998); *Loehrer v. McDonnell Douglas Corp.*, 98 F.3d 1056 (8th Cir. 1996).

54 20 C.F.R. § 639.9(b)(1) (emphasis added).

55 20 C.F.R. §639.9(b)(2).

56 20 C.F.R. §639.7(a)(3).

57 20 C.F.R. § 639.5(c).

58 Cal. Lab. Code §§1400 — 1408 (West 2008).

59 Haw. Rev. Stat. §§ 394B-1 — 394B-13 (2008); Haw. Code R. § 12-506 (Weil 2008).

60 820 Ill. Comp. Stat. 65/1-99 (2008); Ill. Admin. Code tit. 56, § 230 (2008).

61 Me. Rev. Stat. Ann. tit. 26, § 625-B (2008).

62 N.J. Stat. Ann. §§ 34:21-1 -7 (West 2008).

63 N.Y. Lab. Law § 860 (McKinney 2008).

64 Tenn. Code Ann. §§ 50-1-601, 50-1-602, 50-1-603 (LexisNexis 2008).

65 Wis. Stat. §§109.07, 109.075 (West 2008); Wis. Admin. Code. DWD § 279 (2008).

66 V.I. Code Ann. tit. 24, §§ 471 — 478 (LexisNexis 2008).

67 Most people do not realize that although the states pay benefits out of UI taxes collected from employers (and employees in a handful of states), the administrative cost of running the agency that processes these claims is largely underwritten by the DOL. So when the DOL applies pressure to states, the state legislatures, unwilling to fund these costs, are generally very cooperative.

68 http://www.whitehouse.gov/agenda/health_care (last visited Apr. 5, 2009).

69 *See generally* Kaiser Family Foundation, *Employer Sponsored Health Insurance — A Comparison of the Availability and Cost of Coverage for Workers in Small Firms and Large Firms*, Nov. 2008, *available at* http://www.kff.org/insurance/snapshot/chcm0111898oth.cfm (last visited Apr. 4, 2009).

70 Employee Retirement Income Security Act of 1974 (ERISA), as amended, 29 U.S.C. §§ 1001, *et seq.*

71 ERISA § 3(40).

72 *See, e.g., Wightman v. Berkely Administrators of Texas, Inc.*, 2000 WL 287930 (N.D. Tex. 2000) (trade association satisfied commonality requirement because all employers adopting the plan were related to the trade association sponsoring it). MEWA status is important because if the requirements for ERISA coverage are met at the MEWA level, the MEWA, and not each adopting employer, will be required to meet ERISA's documentation, reporting and disclosure requirements. *See, e.g.*, DOL Opinion 81-47A. To meet this requirement, the employers, through the association, must control the design and activities of the MEWA. *See, e.g.*, DOL Opinion. 2005-24A.

73 ERISA § 514(b)(6)(a)(ii).

74 ERISA § 514(b)(6)(A)(i).

75 It is advisable to obtain a ruling from the DOL as to the ERISA-covered status of a MEWA before beginning operation.

76 173 F.3d 713 (9th Cir. 1999).

77 Littler Report, *Total Wage and Hour Compliance: An Initiative to End the Class Action War*, Apr. 2008, *available at* http://www.littler.com/PressPublications/Lists/Littler%20Reports/DispReport.aspx?id=24.

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APPENDIX A:

Staffing Industry Analysts Charts on Contingent Worker Trends

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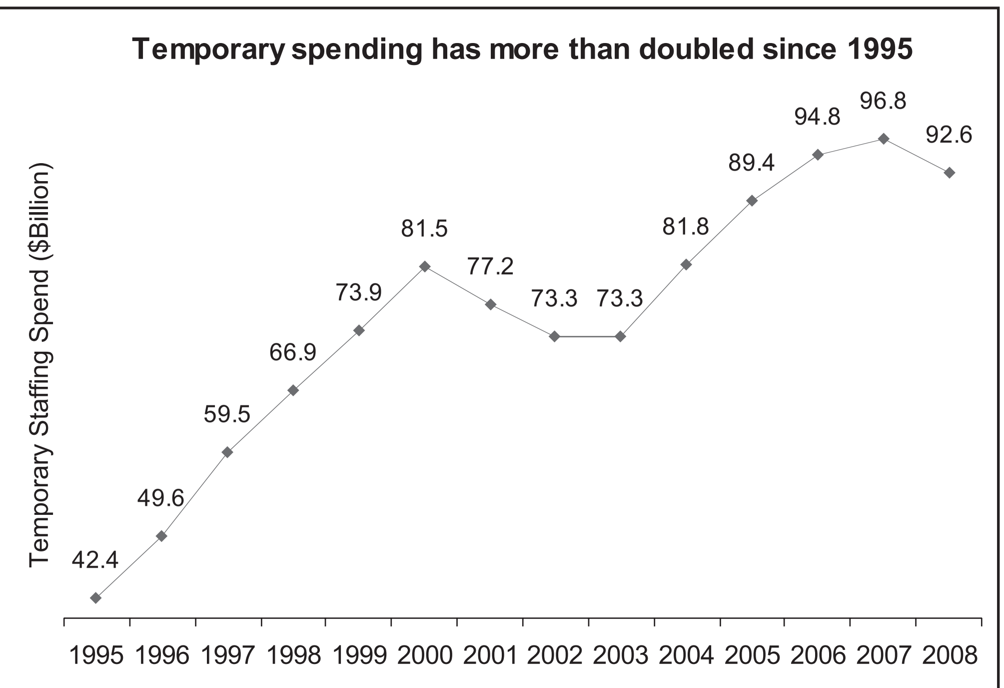
History shows that spending on contingent labor will more than recover after a recession



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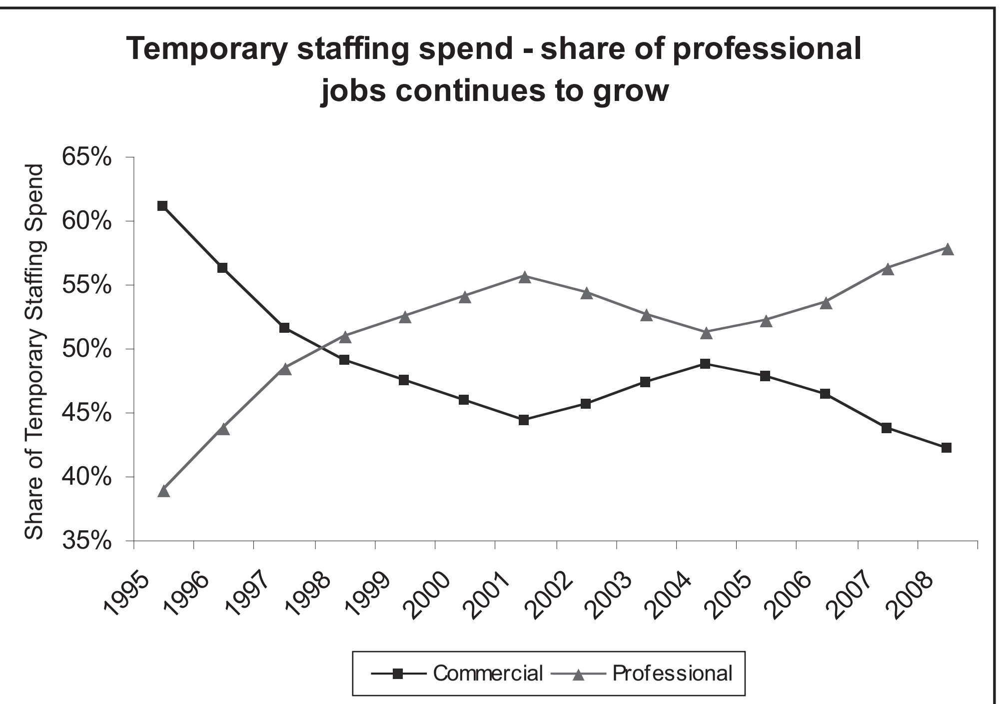
STAFFINGINDUSTRY ANALYSTS

Over time, spending on contingent labor has increasingly been for professional skills

(Note: "Commercial" = Office/clerical or industrial)



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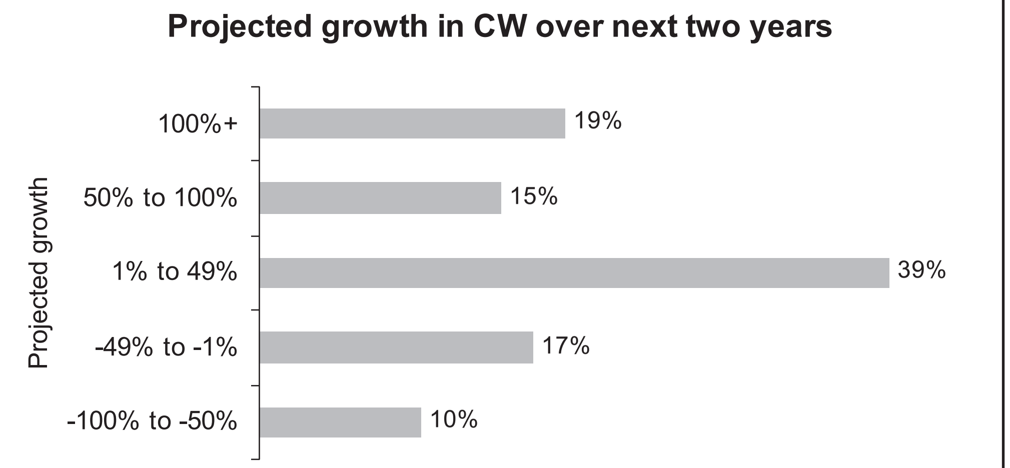
STAFFINGINDUSTRY ANALYSTS

73% of companies (with 1,000 or more employees) said they would grow their contingent workforce by a median of 25% between late 2008 and late 2010. This is consistent with Littler's estimate that 50% of jobs "re-filled" after this recession will be contingent.



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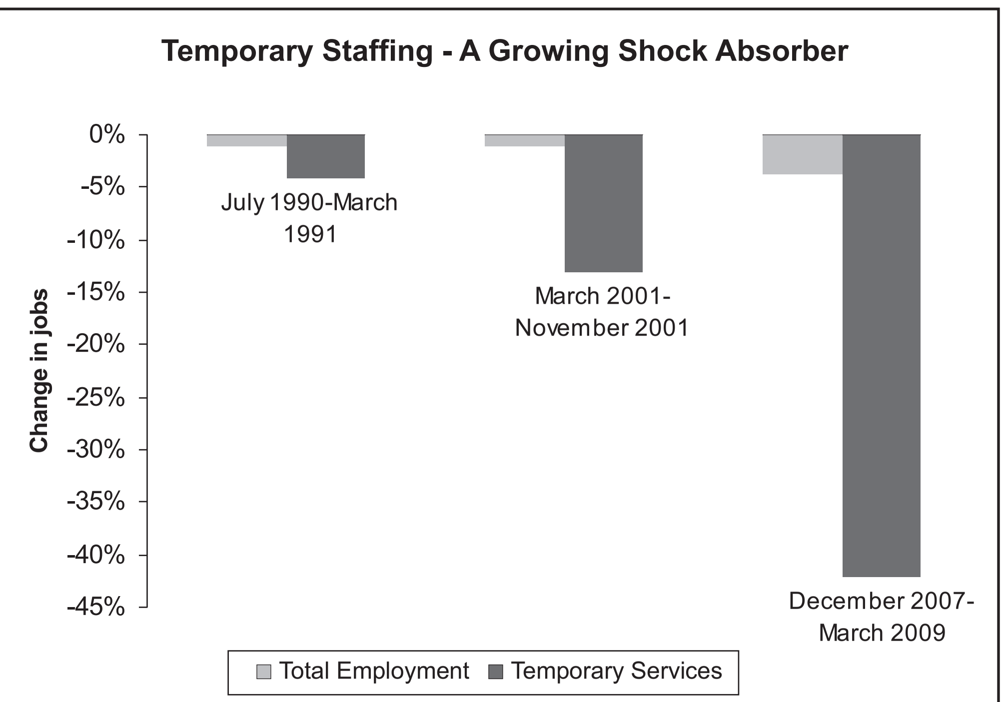
STAFFINGINDUSTRY ANALYSTS

The degree to which contingent jobs are eliminated more than "regular" jobs has significantly increased with each recession



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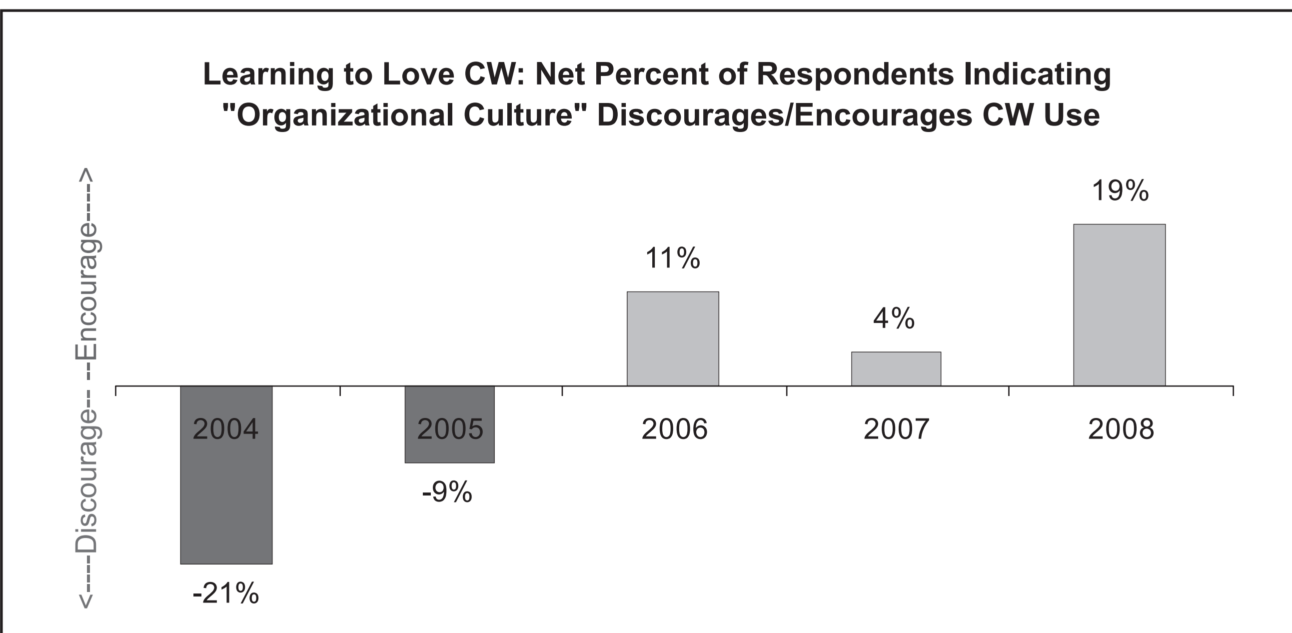
STAFFINGINDUSTRY ANALYSTS

The organizational cultures of many companies have changed from being obstacles to the use of contingent labor to being supportive



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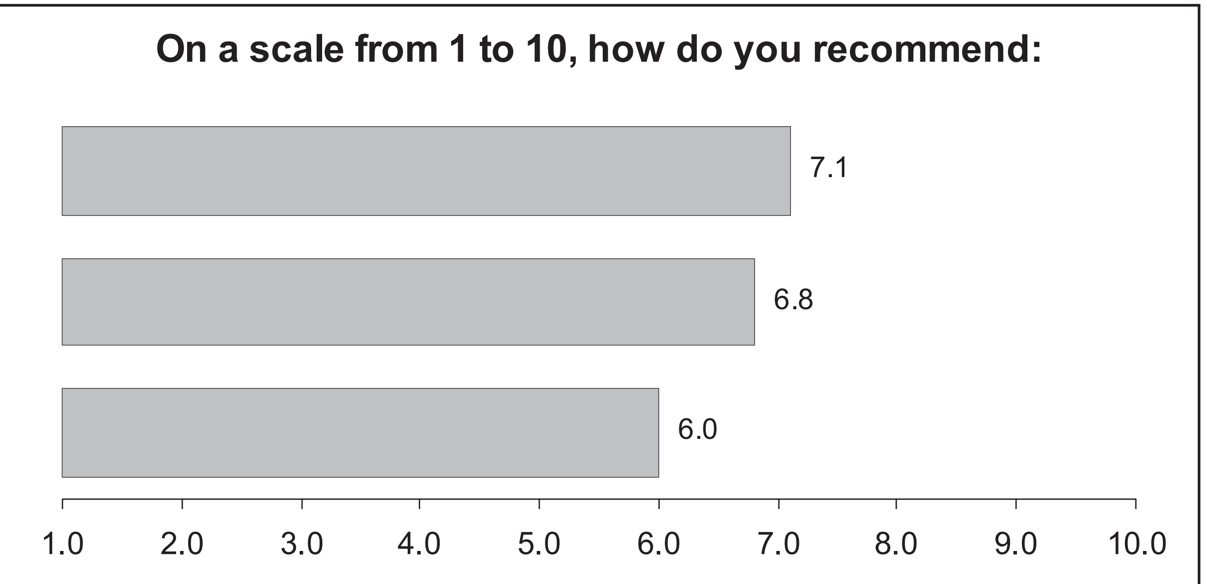
STAFFINGINDUSTRY ANALYSTS

Workers seem to like their staffing suppliers and temporary assignments better than their “regular” employers



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FACTORS TO CONSIDER IN ASSESSING INDEPENDENT CONTRACTOR STATUS[1]

Factor	Indicative of Employee	Indicative of Independent Contractor
Right to Control Work	The employer has the right to control when, where, and how the worker performs the job.	The worker has discretion about when, where and how he/she performs the job.
Tools and Equipment	The employer furnishes the tools, materials, and equipment.	The worker furnishes the tools, materials, and equipment.
Level of Skill/Expertise	The work does not require a high level of skill or expertise.	The work requires a high level of skill or expertise.
Parties' Understanding	The worker and employer believe they are creating an employer-employee relationship.	The worker and employer believe the worker is an independent contractor.
Ability to Discharge Employee	The employer can discharge the worker.	The employer cannot directly discharge the worker.
Tax Treatment	The worker is considered an employee of the employer for tax purposes (i.e., the employer withholds federal, state, and Social Security taxes).	The worker is not considered an employee of the employer for tax purposes.
Benefits	The employer provides the worker with benefits such as insurance, leave, or workers' compensation.	The employer does not provide the worker with benefits.

[1] Whether an employer-employee relationship exists is fact-specific and depends on whether the employer controls the manner and means of the worker's performance. No single factor is determinative of independent contractor status. Instead, the determination requires a balancing of all aspects of the worker's relationship with the employer. This diagnostic tool is not designed to provide legal advice concerning any specific situation. Employers are urged to consult their labor and employment law counsel regarding specific situations and issues.

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Factor	Indicative of Employee	Indicative of Independent Contractor
Employee's Occupation or Business	The worker is not engaged in his/her own distinct occupation or business.	The worker is engaged in his/her own distinct occupation or business.
Regular Business of Employer	The work performed by the worker is part of the regular business of the employer.	The work performed by the worker is not part of the regular business of the employer.
Assistants or other Workers	The worker does not hire and pay assistants or other workers.	The worker hires and pays assistants or other workers.
Payment	The worker is paid by the hour, week, or month rather than the agreed cost of performing a particular job.	The worker is paid for a particular project, rather than being paid on an hourly, weekly, or monthly basis.
Hours of Work and Duration of Job	The employer sets the hours of work and the duration of the job.	The worker sets his/her hours of work and works until the job is completed.
Length of Relationship between Employer and Employee	There is a continuing relationship between the worker and the employer.	A long-term engagement is more consistent with employee status, while a short-term or one-time engagement is more consistent with independent contractor status.
Location of Work	The work is performed on the employer’s premises.	The worker controls the location of the work.
Opportunity for Profit	The worker could not derive a profit (other than wages) from his/her work.	The worker performing the service could derive a profit depending upon his/her managerial skills.
Risk of Loss	Employer has the risk of loss with respect to the worker’s performance of services.	The worker has a risk of loss with respect to performance of services.

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Factor	Indicative of Employee	Indicative of Independent Contractor
Exclusivity	The worker performs services exclusively for the employer.	The worker is free to hold himself/herself out to the public and to accept as many assignments as possible from others.
Costs Incurred	The worker does not personally incur substantial costs to perform the services.	The worker has incurred substantial costs to perform the services.
Custom in Industry	The custom in the trade or industry is for the service to be provided by employees.	The custom in the trade or industry is for work to be performed by independent contractors.
Right to Delegate	The worker does not have the power to delegate.	The worker has the right to delegate all or a portion of duties to others.

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THE INDEPENDENT CONTRACTOR/EMPLOYEE DILEMMA[1]

I. WHY DO EMPLOYERS USE INDEPENDENT CONTRACTORS?

A. Cost Savings

1. Federal and state payroll taxes
2. Reduced or no benefits
3. Overtime pay
4. Insulation from employment litigation

B. Flexibility

1. Used on an "as needed" basis
2. No "personnel" issues
3. Scheduling

II. THE IMPORTANCE OF THE DISTINCTION

A. Employment Tax Liability

1. Federal Insurance Contribution Act
2. Federal Unemployment Contribution Act
3. Personal income tax withholding
4. State unemployment and disability tax

---

1 This checklist is not designed to provide legal advice concerning any specific situation. Employers are urged to consult their labor and employment law counsel regarding specific situations and issues.

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B. Federal And State Civil Rights Acts

1. Title VII

2. ADEA

3. Equal Pay Act

4. State Human Relations Acts

C. Collective Bargaining Considerations (NLRA)

III. TESTS

A. Various Agencies And Courts Use Different Tests To Determine Independent Contractor Status.

B. Agreement With Individual On Status Is Not Controlling.

C. Common Law -- Right To Control Test

1. Analyze control over the means used by the worker to perform the job or the desired result.

2. Factors indicating independent contractor status under common law:

a. Low degree of supervision

b. High level of skill

c. Worker provides supplies, tools and a place to work

d. Wages paid per job vs. salary or per hour

e. No control over details of work

f. Work is not part of employer’s regular business

g. Written contract establishing an understanding between the parties

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D. IRS Tests (FICA, FUTA, Income Tax, Employee Benefits)

1. The IRS has identified 20 factors that indicate whether sufficient control is present to establish an employment relationship.

   The degree of importance of each factor varies and depends upon the occupation and the context in which the services are performed.

2. Consequences of misclassification.

   a. Penalties:

      i. 1.5% of wage paid to misclassified worker (3% if employer failed to file a 1099 for the worker).

      ii. 20% of employee's share of FICA.

      iii. Possible penalty equal to 100% for a willful failure to collect taxes.

   b. 100% of all of employer's back taxes must be paid.

   c. Interest.

3. Form SS-8

   a. Used to request an IRS ruling on a worker's status.

   b. Eliminates risk of misclassification, but IRS is very conservative.

4. The U.S. Immigrations and Customs Enforcement also uses the IRS test.

E. Test For Federal Civil Rights Law

1. EEOC issued a notice in November 1987 delineating the factors it examines in determining whether the relationship between a charging party and an employer is an employment relationship and therefore covered under Title VII.

2. The same factors apply for purposes of ADEA and the Equal Pay Act.

3. The EEOC takes the position that Title VII reaches any individual who is unlawfully denied an "employment opportunity" -- broader than the

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traditional employer-employee relationship.

4. Test adopted by the EEOC is a combination "economic realities" and "right of control" test. The extent of the employer's right to control the manner and means of the worker's performance is the most important factor. Underlying issue: Whose business interest is being served?

5. Factors considered by EEOC (no one factor is determinative):

    a. The extent of control which the respondent exercises or may exercise over the details of the work;

    b. Whether the charging party is engaged in a distinct occupation or business;

    c. The kind of occupation in which the charging party is engaged, considering whether that work is generally done under the direction of a supervisor or by a specialist without supervision;

    d. The skill required in that occupation;

    e. Whether the respondent or the charging party supplies the equipment, tools and the place of work for the charging party;

    f. The length of time for which the charging party was or would have been engaged to work;

    g. The method of payment, whether by time or by the job;

    h. Whether the respondent withholds Social Security or other taxes from the compensation paid;

    i. Whether the respondent provides leave or benefits, including: annual, sick or disability leave; health, medical or life insurance; retirement benefits;

    j. Whether the charging party is or would be covered by workers' compensation;

    k. The manner in which the work relationship may be terminated: by one or both parties, with or without cause, with or without notice and/or explanation;

    l. Whether the work is an integral part of the respondent's business;

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m. Whether the charging party worked or would have been required to work exclusively for the respondent, or whether the charging party was or would have been permitted to perform the same type of work for an employer other than the respondent;

n. Whether the charging party could delegate the work;

o. Whether the charging party is an employer with employees of his/her own;

p. Whether the charging party was or would have been required to make a capital investment;

q. Whether the work affords the charging party an opportunity for profit or loss depending on his/her skills or management abilities; and

r. The intention of the parties in creating the work relationship.

F. Fair Labor Standards Act Test

1. The FLSA test is a pure "economic realities" test.

2. Focus of inquiry is economic dependence.

3. Six factors (all roughly equal):

a. The extent to which the services in question are part of the company's business;

b. The amount of the individual's investment in the company's facilities and equipment;

c. The nature and degree of control retained by management;

d. Individual opportunity for profit or loss;

e. The amount of initiative, skill or judgment required; and

f. The permanency and duration of the relationship.

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4. Penalties for misclassification.

   a. Payment of unpaid overtime premiums;

   b. Liquidated damages; and

   c. Fines up to $10,000 for willful violations.

G. <u>NLRA Considerations</u>

1. Independent contractors are specifically excluded from the protections of the NLRA.

2. Test

   a. Right of control.

   b. Retention of entrepreneurial control to place individual at risk for profit or loss.

H. <u>Factors Considered By The Internal Revenue Service</u>

1. Instructions

2. Training

3. Integration

4. Services rendered personally

5. Hiring, supervising and paying assistants

6. Continuing relationship

7. Set hours of work

8. Full time required

9. Doing work on employer's premises

10. Order or sequence set

11. Oral or written reports

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12. Payment by hour, week, month

13. Payment of business and/or traveling expenses

14. Furnishing of tools and materials

15. Significant investment

16. Realization of profit or loss

17. Working for more than one firm at a time

18. Making service available to general public

19. Right to discharge

20. Right to terminate

IV. EMPLOYER SELF-ANALYSIS

A. To help determine whether a relationship is that of principal and contractor rather than employer and employee, ask the following questions. (These questions provide the framework for an employer self-analysis. They are not intended to be a substitute for advice of counsel concerning a particular situation.)

1. Does the Company have the right to control the manner and method used to perform the service?

2. Has the Company specified the final result that it seeks?

3. Is the work closely supervised by the Company?

4. Does the Company require regular progress reports?

5. Does the individual perform work that differs from the work performed by the Company's employees?

6. Does the individual perform the work off the Company's premises?

7. Does the individual establish his/her own work schedule?

8. Does the individual furnish his/her own tools and equipment?

9. Does the individual consider him/herself to be an independent contractor?

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10. Does the individual operate his/her own business?

11. Does the individual hold him/herself out to the public as a business (e.g., advertising to the public)?

12. Does the individual have a certificate of incorporation, partnership or d/b/a?

13. Has the individual made a significant investment in his/her business (e.g., purchase or lease of a building or office space, purchase of tools and equipment, etc.)?

14. Is the individual engaged by anyone else to perform the same or similar services sought by your Company?

15. If so, what is the relationship between the individual and the other purchaser of services (e.g., employer-employee)?

16. Does the work require a particular skill?

17. If so, is the individual the only one who can do the work?

18. If not, do the Company's employees possess the required skill?

19. Is the individual required to hold any particular license to perform the work?

20. If so, do any of the Company's employees hold such a license?

21. Does the individual file tax returns that indicate self-employment status?

22. Does the Company file 1099 forms with the IRS for those individuals it considers to be independent contractors?

23. Is the individual paid on a project basis rather than on an hourly, weekly, or monthly basis?

24. Does the individual invoice the Company for the services provided?

25. Does the individual use specially prepared invoices that bear that Company's name?

26. Does the individual have the opportunity to make a profit?

27. Does the individual risk any loss?

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28. Will performance of the work require training provided by the Company?

29. Can the Company terminate the relationship at any time?

30. Do the parties have a written agreement?

31. Has the agreement been reviewed by employment law counsel?

32. Has your Company's use (or proposed use) of "consultants" or "independent contractors" been reviewed by employment law counsel? If so, how long ago?

B. Discussion of the foregoing questions will provide a framework to help you evaluate whether a person your Company intends to engage will be considered an independent contractor or an employee under applicable state and federal laws.

Note: If your Company intends to engage people as independent contractors, the proposed relationship and contractor agreements should be reviewed by employment law counsel. Similarly, if your Company already engages people as independent contractors, the relationships and written agreements should be reviewed by employment law counsel.

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