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"A VIEW FROM THE UNITED STATES OF AMERICA: BENEFITS, RISKS AND LEGAL REQUIREMENTS APPLICABLE TO USING NON-EMPLOYEE WORKERS"

Committee: Employment and Industrial Relations Law

Session: The legal advantages and risks of global outsourcing and contracting out and best practices for drafting and implementing cross-border and secondment and employment agreements.

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I. INTRODUCTION

The most recent United States Bureau of Labor Statistics data, released in 2005, revealed that as of that date, 2.5 million workers (1.8% of the total employed) worked "on-call," 1.2 million (0.9%) worked for temporary help agencies, 813,000 (0.6%) worked for contract firms, and approximately 10.3 million workers (equal to roughly 7.4% of total employment) were being treated as independent contractors.

In an age of downsizing, layoffs and mergers, the use of third-party employees and independent contractors can prove to be a strategic move that may provide companies with a competitive advantage. The use of third-party employees and independent contractors can increase employee satisfaction by helping manage overflow or by allowing employers to offer more flexibility to employees in terms of leave time or even long-term scheduling.

The drawback to the use of employees of third-party agencies is that a company might find itself liable for actions toward or by a third-party employee as if that individual was employed directly by the company. State and federal agencies have increasingly challenged the status of workers as independent contractors in an effort to increase their tax revenues. Independent contractor relationships continue to be subject to challenge. Recent court decisions and administrative rulings threaten to undermine the usefulness of, and create increased risks in, characterizing workers as independent contractors. Consequently, it is imperative for companies to contemplate how third-party employees and independent contractors fit into their work forces, how they will use such employees, and what potential liabilities such use might create. By thinking through the relationship, companies can implement a comprehensive plan to manage liability and to prevent any undue obligations.

"Contingent employment" is a catch-all term generally used to refer to all types of employment in which the employee is not a "regular" employee of the employer. The group that makes up contingent employees includes what often are called temporary employees, leased employees, part-time employees, seasonal employees, independent contractors, and casual employees.

II. INDEPENDENT CONTRACTORS

A. Who is an Independent Contractor

Determining whether an employee qualifies as a contingent worker requires a fact-sensitive inquiry, and often varies depending on the context in which the inquiry is made. For example, a contingent worker may be considered a non-employee of a company for purposes of state workers' compensation laws, yet the very same worker may be considered an employee in the context of certain federal and state anti-discrimination laws.

Independent contractors are not employees of the company for whom they perform services, and are not treated as such. They are independent agents who retain the right to control the manner and means by which they perform services, and who are not subject to control except as to the final result to be accomplished. Independent contractors may perform the services as an individual ("self-employed" or "sole proprietor"), or through another business form such as a corporation. They are not paid wages, and do not receive an Internal Revenue Service Form W-2 for the fees that they are paid. If they receive more than $600.00 from the service recipient, then they should receive IRS Form 1099, unless they are incorporated. In addition, if they purchase more than $5,000.00 worth of product from the company, they should also be issued an IRS Form 1099.

B. Tests for Determining Independent Contractor Status

There are few, if any, easy answers as to whether a particular characterization of a worker as an independent contractor can withstand scrutiny, if challenged. The determination of whether a worker is an independent contractor or employee involves a delicate factual balancing. An employer's designation of a worker's status is not controlling. Instead, the status of the worker will be determined by the court or reviewing agency from all the facts and circumstances. While there are many different tests used depending upon the applicable law and jurisdiction, the common law "right to control" test is the one most often used.

1. Common Law Agency or "Right to Control" Test

Laws under which the common law "right to control" test is applied include: the common law of most states to determine the liability of employers for the torts of their employees; a modified version under the Internal Revenue Code; the National Labor Relations Act ("NLRA"); the Employee Retirement Income Security Act of 1974 ("ERISA"); federal employment discrimination laws in some federal circuits. In addition, the worker's compensation and unemployment insurance laws of many states utilize a modified right to control test.

Under the common law test, one person is the employee of another if the employer retains the **right to control** not only the **results** to be obtained but also the **manner** and **means** by which the results are to be accomplished.

Control means the right to control rather than the necessary actual exercise of control. The service recipient may leave the details of the job to the worker, but if the service recipient has the power to direct the worker, the worker is not an independent contractor.

There are three commonly recognized explanations of the common law agency test:

- The **Restatement (Second) of Agency** § **220(2)** lists ten factors, among others, that are to be considered: 1) the **extent of control** which, by the agreement, the master may exercise over the details of the work; 2) whether or not the one employed is engaged in a **distinct occupation or business**; 3) the **kind of occupation**, with references to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision; 4) the **skill** required in the particular occupation; 5) whether the employer or the worker supplies the **instrumentalities, tools, and the place of work** for the person doing the work; 6) the **length of time** for which the person is employed; 7) the **method of payment**, whether by the time or by the job; 8) whether the work is a part of the **regular business** of the employer; 9) whether the parties believe they are creating the relationship of **master and servant**; and 10) whether the principal is in a **distinct business**.

In December 2000, the National Labor Relations Board ("NLRB" or Board) reaffirmed the common law agency test in a ruling involving the employee/independent contractor status of delivery truck drivers. The NLRB held that the drivers were employees, based on a number of factors, including: the drivers perform work which is substantially the same as that of the employee drivers; their work constitutes the essential functions of the employer's operations as a package pickup and delivery service; they work full time, are trained by the employer and need not have prior experience; they do business in the employer's name with substantial guidance from and control of the employer; they are not allowed to use their vehicles to make deliveries for anyone other than the employer and they must display the employer's logo on their vehicles; the routes, base pay and the amount of freight to be delivered daily on each route are determined by the employer; they have no proprietary interest in their routes or significant opportunity for entrepreneurial gain or loss; and they have no right to add or reject customers. ***Corporate Express Delivery Sys.***, 332 N.L.R.B. 1522 (2000), *rev. denied*, 292 F.3d 777 (D.C. Cir. 2002).

- For years the Internal Revenue Service ("IRS") applied a **"Twenty Factor Test"** set out in Revenue Ruling 87-41, 1987-1 C.B. 296. However, the IRS has moved away from strict reliance on the Twenty Factors, and has replaced this test with a new approach focusing on three categories to determine if a worker is an employee or independent contractor: Behavioral Control, Financial Control, and Type of Relationship.

Behavioral Control: Facts that show whether the business has a right to direct and control how the worker does the task for which he is hired, including the type and degree of:

1. **Instructions** the business provides the worker, and
2. **Training** the business provides the worker.

Financial Control: Facts that show whether the business has the right to control the business aspects of the worker's job. These include:

1. Reimbursement of business expenses;

2. Extent of worker's investment;

3. Extent workers services are available to the relevant market;

4. How the business pays the worker;

5. Extent to which the worker can realize a profit or loss (an independent contractor can make a profit or suffer a loss; an employee cannot).

Type of Relationship: Factors that show the "type of relationship" (as provided by the IRS in Publication 15A)

1. Written contracts describing the relationship the parties intend to create;

2. Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay or sick pay;

3. Permanency of the relationship: Is the worker hired with the expectation that the relationship will continue indefinitely rather than for a specific project or period? Is so, such expectation indicates an employer-employee relationship rather than an independent contractor relationship;

4. Extent to which services performed by the worker are considered a key aspect of the company's regular business. The more important they are to the company's business, the more likely the business will have the right to direct and control the worker's activities, thus indicating an employer-employee relationship.

Note: Before applying this "updated right-to-control test," employers should determine whether they are already exempt from proving an independent contractor relationship by either safe haven provisions or statutory exemptions. If a worker does not fall within either of these categories, the IRS will review the employer's classification of the worker as an independent contractor under this "right-to-control" test.

- In ***Nationwide Mut. Insur. Co. v. Darden***, 503 U.S. 318 (1992), the Supreme Court, in interpreting the meaning of "employee" under ERISA, held that since Congress had not defined "employee" in the statute, the common law test should apply. Because most federal (and state) statutes fail to define "employee" in any detail, courts interpreting federal statutes often apply a common law test based on *Darden*. *See, e.g., Jenkins v. Southern Farm Bureau Cas.*, 307 F.3d 741 (8th Cir. 2002). The Supreme Court, relying upon the Restatement (Second) of Agency and IRS guidance, summarized the common-law test as follows:

> In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required, the source of the instrumentalities and tools; the location of work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's role in hiring and paying assistants; whether the work in question 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 hiring party.

2. Economic Realities Test

The economic realities test, used primarily under the Fair Labor Standards Act ("FLSA"), focuses not so much on whether the service recipient controls the manner and means by which the worker performs the work but rather on whether the worker is, as a practical matter, economically dependent upon the service recipient.

There are **six** factors principally considered by courts and reviewing agencies under the economic realities test:

1. the extent to which services are part of the alleged employer's business;

2. the nature and degree of control exercised by the alleged employer;

3. the extent of the relative investments of the worker and the alleged employer;

4. the degree to which the worker's opportunity for profit and loss is determined by the alleged employer;

5. the skill and initiative required for performing the job; and

6. the permanence and duration of the relationship.

Senate Proposal. Legislation introduced in the U.S. Senate on September 12, 2007 would amend the Revenue Code to provide strengthened procedures to determine and enforce the proper classification of employees and independent contractors. Senate Bill 2044, sponsored by Senators and presidential candidates Barack Obama (D-IL), Hillary Clinton (D-N.Y.) among others, would: require employers to treat workers misclassified as independent contractors as employees for employment tax purposes after the Treasury Department reaches a determination of misclassification; repeal the ban on Treasury regulations or revenue rulings on employee/independent contractor classifications; and eliminate the defense of "industry practice" as a justification for misclassifying workers as independent contractors. Significantly, the proposal, directing Treasury and the DOL to work cooperatively on this issue, requires the Department of Treasury to establish a procedure for workers to petition for a determination of their employment status and prohibits employers from retaliating against workers filing a petition. Touting its revenue-enhancement features, sponsors of the proposed legislation claim that the bill is designed to "close a loophole" in federal tax law by which employers can avoid paying employment taxes and workers' compensation. The bill is currently being considered in committee. *See* Daily Lab. Rep. No. 178 (Sept. 14, 2007), A-7.

3. Combination or "Hybrid" Test

Some courts have adopted a hybrid test, combining the economic realities test with common law principles. Usually, however, the right-to-control factor is still paramount.

4. The ABC Test

Many state unemployment and workers' compensation insurance statutes use what is commonly referred to as the ABC Test. Under the ABC Test, services performed by an individual for remuneration will be entitled to unemployment insurance **unless** the following factors exist:

a) The individual performing the services has been and will continue to be free from control and direction in the performance of services, both under the contract of service and in fact; and

b) The services are performed outside all of the premises of the service recipient or the services are performed outside the usual course of the business for which the service is performed; and

c) The individual performing the service is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the services performed.

While many states use the ABC Test under their unemployment statutes, some simply use a combination of A and B or A and C. For example, Virginia uses an A/B test while Pennsylvania uses an A/C test. Further, some states use some form of the common law test.

C. How to Avoid Inadvertent Coverage of Independent Contractors Under Employee Benefit Plans

The issue of "inadvertent coverage" is often discussed in the context of a line of cases relying upon the Ninth Circuit's decision in a case involving Microsoft Corporation. The issue arises because most benefit plans are applicable to specified groups of "employees." References in plan documents to "employees" were thought to be sufficient to exclude independent contractors, who are not intended to be covered. However, the *Microsoft* cases proved that is not necessarily true.

Vizcaino v. Microsoft Corp., 97 F.3d 1187 (9th Cir. 1996) ("***Microsoft I***") involved a group of workers who were designated by Microsoft as "freelancers" and "independent contractors." The workers signed agreements in which they agreed they were independent contractors and would be responsible for all of their state and federal taxes, withholdings, insurance and other benefits. The workers were fully integrated into Microsoft's work force; they worked on-site and on work teams along with Microsoft's regular employees. They also shared the same supervisors, performed identical functions and worked the same core hours as regular employees. However, after an IRS ruling found that the workers were employees for payroll purposes, the workers requested participation in Microsoft's employee benefits plans. The plan administrator denied the workers benefits and the workers sued.

After trips to the federal court of appeals and the U.S. Supreme Court, the workers were found eligible to participate in Microsoft's benefit plans because, in part, the "agreements" naming the workers as independent contractors were inconsistent with the actual relationship between the parties. In December 2000, Microsoft and attorneys for the temporary workers agreed to a **$96.9 million** settlement. *See* Daily Lab. Rep. No. 240 (Dec. 13, 2000), AA-1.

In the latest installment of this case, the district court awarded the plaintiffs' attorneys $27 million in attorneys' fees, representing 28 percent of the total award of $96.8 million. Microsoft appealed the award, alleging that the lower court's decision to base the award on a flat percentage of the amount recovered was unreasonable given the large size of the award. The Ninth Circuit disagreed and upheld the award as a reasonable exercise of the lower court's discretion. The court found significant the fact that 25 percent is standard in percentage-based cases, plaintiffs' counsel did an extraordinary job, the case was exceptionally risky, counsel's efforts generated benefits beyond the cash settlement award, and the 28 percent award was lower than the market rate for similar cases. ***Vizcaino v. Microsoft Corp.***, 290 F.3d 1043 (9th Cir.), *cert. denied*, 537 U.S. 1018 (2002).

Not all courts have followed the holding in the *Microsoft* cases. In one such case, because the workers at issue had specifically acknowledged in their Independent Contractor Agreements that they would not be entitled to benefits, the court found the agreements were valid and enforceable. Second, the court found that by virtue of the Agreements, the workers had agreed not to be "eligible" for benefit plans; therefore. the plan language excluded them from eligibility.[1]

In another case, loan originators who provided services pursuant to agreements designating them as independent contractor applied for benefits under the employer's ESOP, contending that they were employees and therefore covered under the Plan. The employer's claims committee found that the workers were not "employees," and that even if they were, they would not come under the Plan's definition of "employee." The court upheld the employer's decision under the arbitrary and capricious standard of review.[2]

In a third, more recent case, the court dismissed a class action brought by former and present leased employees who claimed their employer wrongfully classified them in order to deny them access to certain benefits. The court noted that the employer's benefit plans excluded from eligibility "leased employees," and specifically stated that "leased employees are not employees." Further, even if the workers qualified as common law employees, they were not eligible for benefits because the employer's plans explicitly excluded common law employees who are defined as leased employees or independent contractors under company policy.[3]

Note: On June 11, 2007, U.S. Representative Carolyn McCarthy (D-N.Y.), along with two co-sponsors, reintroduced legislation (H.R. 2657) which would prohibit employers from forcing employees nearing retirement to become independent contractors and lose their eligibility to receive full pension benefits. *See* Daily Lab. Rep. No. 61(Mar. 31, 2003), A-4.

1. What Legal Requirements Apply to Benefit Plans?

Employee benefit plans are governed by both the Internal Revenue Code, as amended ("Code") and ERISA. The Code governs the status of benefit plans for tax purposes, while ERISA addresses non-tax requirements affecting benefit plans, including participants' rights under the plans.

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1 *Capital Cities/ABC, Inc. v. Ratcliff*, 953 F. Supp. 1228 (D. Kan. 1997), *aff'd*, 141 F.3d 1405 (10th Cir. 1998), *cert. denied*, 525 U.S. 973 (1998).

2 *Trombetta v. Cragin Fed. Bank for Sav. Employee Stock Ownership Plan*, 102 F.3d 1435 (7th Cir. 1996).

3 *Casey v. Atlantic Richfield Co.*, 2000 U.S. Dist. LEXIS 6836 (C.D. Cal. Mar. 29, 2000).

2. Code and ERISA Rules Concerning Independent Contractors

The Code provides that employee benefit plans must be maintained for the exclusive benefit of employees and their beneficiaries. Similarly, employee benefit plans subject to ERISA must be maintained for the exclusive benefit of employees. Thus, only employees, and not independent contractors, have standing to bring a claim for benefits under ERISA. Based on this exclusive benefit rule, companies generally must exclude independent contractors from participating in their employee benefit plans. If a tax-qualified plan fails to comply with the Code by permitting non-employees to participate, the IRS may disqualify the plan.

3. What can a Company do to Minimize its Risks Following *Microsoft I*?

A company should examine all plans and arrangements, and ensure that eligibility provisions use clear language excluding workers classified as independent contractors. However, certain nondiscrimination tests may limit an employer's ability to exclude all of its workers from its tax-qualified plans.

Under one approach, a change to plan language can be adopted as a clarification. In addition to addressing the concern described above, this characterization helps avoid ERISA's prohibition of the retroactive elimination of a vested accrued benefit (such as pension benefits). In fact, with respect to a defined benefit pension plan (or a defined contribution plan subject to the minimum funding rules), a substantive change prospectively reducing (or eliminating) benefit accruals could not be made without providing 15 days' advance notice of the amendment to participants.

While a strong argument can be made that ERISA's prohibitions do not apply to amendments that are clarifying amendments, an employer should consider providing that, in the event that the amendments are determined not to be clarifications, but modifications of the existing language, the amendments will at least be effective from and after their date of enactment.

A companies should carefully consider eligibility as part of its ERISA claims procedure and interpret applicable plan language.

Such administrative-based responses focus on plan administrative procedures and the way claims are considered. A much stronger employer position is created if the fiduciary thoroughly considers the claim and analyzes plan language to determine whether individuals are eligible.

It is important that plan administrative procedures regarding the handling of claims be consistent, and ensure that any claims regarding eligibility for participation are thoroughly investigated and determinations are issued which will be given deference by reviewing courts. A claims procedure should provide a written record and create the best opportunity that the claims administrators' determination will be upheld under an arbitrary and capricious review standard in subsequent litigation.9

Benefit plans must contain language granting full discretion to the plan administrator to interpret the plan and decide claims ("*Firestone* language"). *Firestone* language is a necessary predicate to application by a court of the most deferential standard of review of a plan administrator's determination – the "arbitrary and capricious" standard.[4] If this standard is applied, a plan administrator's decision will be overturned only if the decision is determined to be arbitrary and capricious.

Benefit plans should provide that a written claim for benefits must be filed. This requirement provides the best opportunity for ensuring that the company is on notice when the eligibility issue is raised. Reviewing courts have barred employee claims for ERISA benefits where the employee failed to follow a reasonable claims procedure which required written, rather than oral, application to a local benefits administrator.

Benefit plans should provide that the claims administrator has the right to hold a hearing or otherwise obtain and consider documentary evidence. These procedures will help ensure that a thorough record is created to support the administrator's decision. The record should include the administrator's analysis of relevant issues, as well as the conclusions drawn from that analysis.

Note with respect to any procedural changes that it will be necessary to advise participants of the new procedures, through summary plan description, summaries of material modifications and/or posted notices describing the changes.

A company should ensure that it has accurately classified workers and independent contractors and that it has structured a strong independent contractor relationship.

A company should include careful language in its agreement with independent contractors acknowledging that benefits will not be provided, rejecting any offer of benefits and, to the extent permitted by law, waiving any right to benefits.

[4] *Firestone Tire and Rubber Co. v. Bruch*, 489 U.S. 101 (1989).

D. What Other Risks Does A Company Have When Using Independent Contractors?

1. Tax Liability Risks

a) Federal Income Tax

An employer must deduct and withhold federal income tax from the wages that it pays to common law employees. An employer is liable for the amount of income tax to be deducted and withheld, even if the tax is not collected from the employee.

Inappropriately treating a worker as an independent contractor instead of an employee may have severe consequences under the Code. A company that is found by the IRS to have misclassified employees as independent contractors may be responsible for paying all withholding taxes, plus interest, even if the workers already paid the taxes themselves.

IRS Form SS-8, entitled "Determination of Employee Status for Purposes of Federal Employment Taxes and Income Tax Withholding" contains questions drafted by the IRS to determine the status of a worker.

Code Section 3509 operates to limit an employer's liability when the employer fails to deduct and withhold income tax by reason of treating an employee as an independent contractor. Under Section 3509, the employer's liability for withholding is limited to 1.5% of the wages paid the employee, or, in the event that the employer fails to withhold and also fails to timely file any returns or statements that would be required for independent contractors, the employer's liability increases to 3% of the wages paid. Section 3509 does not apply if the employer is found to have intentionally disregarded the requirement to withhold and deduct income tax.

b) Federal Insurance Contribution Act ("FICA") Tax

FICA imposes a tax on employees and employers which is measured by the amount of wages paid to the employee and consists of old age, survivor and disability insurance (Social Security) and hospital insurance (Medicare). Employers are required to deduct and withhold the employee portion, and to pay the employer portion, of FICA tax.

As with income tax, Code Section 3509 operates to limit an employer's liability when the employer fails to deduct and withhold the employee portion of FICA tax by reason of treating the employee as an independent contractor. The employer's liability is limited to 20% of such portion, or, if the employer fails to timely file all returns required of the employer for an independent contractor, the employer's liability increases to 40% of the employee's portion of the FICA tax. Section 3509 relief is not available to an employer who intentionally fails to withhold FICA tax or to an employer who withholds income tax but fails to withhold FICA tax. Section 3509 does not affect the employer's liability for the employer portion of FICA tax.

c) Federal Unemployment Tax Act ("FUTA") Tax

FUTA tax is imposed upon employers and is not deducted or withheld from employee's wages.

Code Section 3509 does not apply to reduce the employer's liability for failure to pay FUTA tax, even if such failure was due to the employer treating the employee as an independent contractor.

d) Federal Interest and Penalties

Interest and penalties will also accrue for failure to pay required taxes. Section 3509 does not relieve an employer from liability for any interest or penalty arising from a failure to deduct and withhold taxes.

Note: While not dropping its pursuit of businesses who misclassify workers as independent contractors and fail or refuse to pay the appropriate taxes, the IRS in recent years has softened its stance in recognizing that there are often legitimate business reasons to retain independent contractors. The IRS will continue to pursue suspected cases of misclassification, paying particular attention to businesses who suddenly "shift" classification of their workers. The test, according to the IRS is "standard industry practice" coupled with the particular company's past practices of classifying workers. Employers are usually safe when both factors point to the use of independent contractors. *See* Daily Lab. Rep. No. 207 (Oct. 8, 1999), A-3.

e) State Taxes

Similarly, employers must deduct and withhold state income taxes from the wages that it pays to common law employees. In addition, employers must make unemployment insurance and other contributions (disability insurance, employment training) on behalf of its employees. Inappropriately treating a worker as an independent contractor instead of an employee may subject the employer to back taxes, interest and penalties. Notably, the state of California requires that "service-recipients" (businesses/employers) report their "service-providers" (independent contractors). In addition to California, Iowa, Massachusetts, Minnesota, New Hampshire, and New Jersey also require some sort of independent contractor reporting.

2. FLSA/Wage-Hour Risks

Minimum wage, overtime and recordkeeping requirements of the FLSA apply to all non-exempt individuals who are employees under the "economic realities test." The "economic realities" test incorporates the common law factors of the right to control, as set forth earlier.

Violations of the FLSA can result in liability of up to three years and double damages for a willful violation, and two years of actual minimum wage and overtime wages owing for a non-willful violation. In certain circumstances the U.S. Department of Labor can also pursue civil monetary penalties for repeat willful violations.

3. Intellectual Property Risks

"Intellectual Property" is a term which collectively refers to copyrights, trademarks, patents, and trade secrets. This property may be considered to be the product of the employee/independent contractor and may be owned by the hiring company.

Intellectual property ownership issues should not be ignored when considering alternative work arrangements. The distinction between employee and independent contractor carries with it significant implications for the retention of intellectual property rights relating to work product. Where a company uses independent contractors to create intellectual property, the ownership rights may remain with the independent contractor unless a written contract between the parties establishes that such rights have been assigned or transferred to the service recipient. Without an express assignment, the employer may have only a license to use the intellectual property limited to the use intended at the time the relationship was established.

a) Copyright and Similar Rights

Many employers have heard of the "work made for hire" or "work for hire" doctrine, but do not have a complete understanding of its application. A "work made for hire" exists only when: (1) a copyrighted work is prepared by an employee within the scope of his or her employment; or (2) certain types of works (e.g., periodicals, motion pictures, tests) are created where the work is specially ordered or commissioned and the contract between the parties states the work will be treated as a "work made for hire." Contractual language may be ineffective if the individual is not an employee as determined by the facts which surround the relationship between the parties. Express assignment or transfer of ownership or a specific agreement to treat certain work product as a "work made for hire" is required in order for an employer to obtain ownership of copyrighted works created for it by an independent contractor.

b) Patents

A company owns all inventions created by an employee or an independent contractor in the course of the company relationship only if there is an agreement between the worker and the company. An assignment agreement should be executed with all workers who may be in a position to invent (which could be a larger universe of workers than you might expect). If there is no agreement regarding ownership, the nature of an independent contractor relationship will be examined to determine whether the parties intended the hiring party to have any rights that went beyond the term of the agreement. If there is an employer/employee relationship, but no written assignment, the employer receives only "shop rights," which is a non-exclusive license to use the invention.

c) Trade secrets

A trade secret can be any secret information used in business, which has economic value (*i.e.*, it gives the business an edge over competitors) because of its secrecy. Each state has different laws which govern the protection of trade secrets. An obligation to protect the trade secrets of another may arise from a relationship between parties. Having confidentiality and assignment provisions in an agreement is the best method of establishing that trade secrets may be created or used by the worker and that ownership rests with the hiring party.

d) Trademarks

A trademark is a word, design or other device that identifies the source of a product or service. A "logo," product packaging, or interior design may be protected under copyright and trademark law. Therefore, it is important to make certain an assignment of copyright is obtained when such works are created, even though you may think they are only trademarks. An idea for a product or trademark, before it is used in connection with a product or service, can be protected as a trade secret, and rights should be transferred through an assignment. Also, use by the creator should be prohibited or restricted.

4. Tort Liability Risks

Employers are liable for the torts committed by their employees within the scope of their employment. Thus, one potential benefit to the use of independent contractors is that the service recipient will not necessarily be liable for the torts committed by independent contractors, even if those torts are committed during the course of performing services for the service recipient.

However, there are several exceptions to the general rule of the non-liability of a service recipient for torts committed by independent contractors. Thus, for example, service recipients have been held liable for the torts of independent contractors under the following theories:

- Negligent retention of the independent contractor.
- Failure to provide reasonably safe work premises for the independent contractor.
- Providing negligent directions to the independent contractor.
- Failure to require the independent contractor to comply with applicable laws and codes.
- The work performed by the contractor presents an unreasonable risk of harm to the public or where it is inherently dangerous.
- Failure to inspect the work performed by the independent contractor.
- Employers may be liable under OSHA for hazards created by independent contractors. OSHA uses the multiemployer worksite doctrine to evaluate these issues.

E. Contracting with Independent Contractors

As you manage independent contractors you should always use an applicable Independent Contractor Agreement as your “road map” to determining the obligations of the company and those of the contractor. The role of a manager of contractors is very different than the role of a supervisor of employees. You are responsible for ensuring that they fulfill the terms of their contract with the company, but you are **not** there to instruct or train the contractor on how to perform services under the contract. The manner and means the contractor chooses to use are not controlled by the company in any way. The following are some suggestions.

- Ensure that the written contract is discussed with all potential contractors, and that the contractors understand the contract and have had an opportunity to read it. If the contractor wants to take it home, consult with someone else about it, or have someone else review it before signing, they should be given the opportunity to do so.

- Accurately describe the key provisions of the contract to the contractor. If the contractor has questions which you cannot answer, be sure to tell the contractor you will get back to the contractor with answers. No contractor should sign a contract that he or she does not understand.

- No requests for revisions should be denied outright.

- Terminate the contract if you need to do so; do not "fire" the contractor.

- If a contractor breaches the agreement, enforce the liquidated damages provision contained in the contract.

III. CONTRACT AND LEASED EMPLOYEES

A. What is a Contract Employee?

Contract employees are employed by a third-party vendor who not only performs the administration of all payroll, benefits, and other human resources activities, but who also is the sole employer of the workers. Thus, the contracting company will recruit, screen, hire, possibly train, set a worker's wages, withhold taxes and social security, and provide workers' compensation coverage. Typically, the contracting company also will direct the work of its employees. The service recipient is not an employer of the contract employee.

What's the difference between contract employees and independent contractors? Contract employees are employees of a contract company with whom a client has contracted for services. The employees may perform work on the client's premises, but the contract company directs the employees' work. Independent contractors is the term usually used to describe self-employed workers who may or may not perform their services on the client's premises.

B. Leased Employees

Leased employees or employee leasing refers to the concept of a company placing some of its work force onto the payroll of an employee leasing firm, or retaining services of the employees of an employee leasing firm. (Temporary employees are often also leased employees under this definition.) The administration of payroll, benefits, and other human resources activities are the responsibility of the employee leasing firm, while the workers are told what work to perform and how to perform a task by the client. Under a different model, a company may recruit, screen, or train employees, which it then places on the payroll of a staffing agency who leases the employees back to the company, thereby transferring responsibility for payroll administration.

Leased employee is also a defined term in the Internal Revenue Code of 1986, as amended. For tax code purposes, a leased employee means: an individual, who is not an employee of the recipient providing services to a "recipient organization" pursuant to an agreement between the recipient organization and a leasing company, which services are performed for the recipient organization by the individual on substantially a full-time basis for at least a year; and the services are performed under the primary direction and control of the recipient organization.

States have begun to regulate leased employees as a licensed industry because of abuses by some leasing firms in the conditions of employment. Thus, some states require that a leasing company obtain a certificate from the state tax department that the company has complied with withholding requirements; other states have set legislative requirements defining how a leasing company will provide workers' compensation and unemployment insurance.

C. The Advantages and Disadvantages of Contract or Leased Employees

1. Advantages of Utilizing Contract or Leased Employees

The advantages of using contract or leased employees are many:

- Utilizing leased or contract employees provides many advantages, including:
- Increased competitiveness by permitting companies to focus on "core functions," allowing them to downsize staffs and reduce related cots as needed, leaving resources available for future "core" job creations.
- Potential for avoiding coverage under certain employment-related laws.
- Potential for decreasing administrative costs by allowing a leased employee company who concentrates on efficiently controlling human resource costs to provide services.
- Increased efficiencies through flexible staffing that can react quickly and with ease to expand and contract a work force through peaks and valleys of work.

- Increased efficiencies through availability of experts in providing certain services or functions.

- Potential for better management of the provision of employee benefits to small or mid-size companies through better insurance rates which might attract talented workers and workers with special skills.

- Economics of scale in the provision of services and related goods (*i.e.*, cleaning supplies or food supplies and equipment).

- Easing the burdens of compliance with complex employment-related statutes.

- Obtaining workers on a temporary basis with specialized skills who would otherwise not be available.

- Increased security of remaining traditional workers and an increase in job opportunities for non-traditional workers.

- Increasing the satisfaction of workers in non-traditional work relationships, including more flexibility to be active participants in other areas of the world besides work.

- Utilizing leased or contract employees may also present certain disadvantages to companies:

- Potential joint liability for damages, even though the company may have relinquished responsibility for ensuring compliance with relevant law to another company.

- Some state and federal laws make the service recipient liable if the service provider fails to make required tax payments or contributions.

- The use of true "leased employees" may raise separation pay issues regarding liability if the employment relationship is terminated even though the worker performs similar services for the company the next day.

- Resolving issues of loyalty and economic security which may exist with respect to non-employee workers, as well as resolving how best to foster motivation amongst their workers.

- Possible tendency to under invest in training and skills development and education.

- Morale issues created when non-employee workers do not enjoy the same benefits of employment as core workers working at similar types of jobs.

2. Risks of Utilizing Contract or Leased Employees

The risks of using leased and contract workers also include, as with independent contractors, the risk that the company using those workers' services may be liable for benefits based on the employee status of the workers.

In 2002, King County, Washington settled a class action lawsuit for benefits that had been filed by temporary contract workers. Under the settlement agreement, the county agreed to pay **$14 million** in past benefits and retirement credits, plus attorneys' fees. The county hired the workers through an outside payroll agency. The workers argued that they were employees of the county and qualified for benefits, while the county argued that the workers were employees of the third-party payroll agency. Before the settlement, a court had found that the workers were eligible employees under the county's medical, dental, vision, and life insurance, were entitled to retirement benefits, and were entitled to paid vacations, holidays, and sick leave. The court based its finding on the fact that the employees worked with and were controlled and supervised by the government and therefore qualified as common law employees regardless of their classification as temporary workers and payment through another company.

The litigation against Microsoft has led that company to change its policy on the use of temporary employees, limiting the tenure of such employees to one year's employment at a time with a 100-day break between each assignment at the company. Part of the motivation for the change, Microsoft announced, was to clarify the difference between employees of staffing agencies and regular Microsoft employees. The change in policies may very well have been motivated by recent court rulings that reinforce that a company's potential liability for legal violations is not influenced by a worker's relationship with a third-party staffing agency. In both the Microsoft and King County cases, the court refused to apply a different analysis for determining employee status due to the involvement of a third-party staffing agency. Of particular note is the Microsoft case, in which the U.S. Supreme Court refused to review the question whether individuals who are employed by temporary employment agencies can simultaneously claim benefits from the employment agency and the company using the agency's services. Thus, the Court implicitly endorsed the lower court's ruling that temporary employees can be employees of a client company while being employees of a staffing agency.

D. Legal Responsibilities Toward Third-Party Employees

Generally, the employment status of an individual performing services through a third-party vendor is based upon a particular law's standard for employment status. However, in certain circumstances, additional tests or specific standards applicable to temporary or leased employees are found in employment-related statutes. The most commonly cited federal and state laws with provisions affecting leased employees are described below.

The discussion is merely designed to flag issues of liability for employers. It is not an exclusive list, and to the extent that the discussion does flag issues of liability, a company should develop a concrete plan with experienced counsel for managing such liability risks.

E. Federal Anti-Discrimination Laws - in General

Companies who use the services of third-party staffing agencies, as well as the staffing agencies, may be liable for discrimination against a temporary or leased worker under Title VII of the Civil Rights Act, the Age Discrimination in Employment Act (ADEA), or the Americans with Disabilities Act (ADA). In late 1997 the EEOC issued an official policy guidance on contingent workers. On the key question of liability, the EEOC explained its position that both staffing firms and their clients share responsibilities toward temporary or contingent workers under the federal anti-discrimination laws under one of two theories -- either as joint employers or as "third party potential interferers"-- if both have the right to control the worker. In addition, companies should be especially aware of particular complexities, discussed below, involving disabilities discrimination and sexual harassment.

Potential discrimination in a leased employment situation may arise with regard to both placement decisions and circumstances on the job. If a worker is denied a placement for discriminatory reasons, the EEOC notes that the staffing agency may be held liable for discrimination as an employer for discriminatory job assignment, as a third party for interfering with the worker's opportunities, and as an employment agency for discriminatory job referrals. A staffing agency may be liable for its own discriminatory decisions or for implementing discriminatory selection criteria of a client company. A client that rejects workers for discriminatory reasons may be liable as a joint employer or third-party interferer.

For discrimination on the job, a client may be liable for discriminating against a worker who qualifies as an employee on the same basis that it would be liable for discriminating against any of its other employees. The EEOC notes that even if the worker does not qualify as an employee, the client may still be liable for discriminating against the worker if its conduct interferes with the worker's employment opportunities with the staffing firm. A staffing firm may be liable for discrimination on the job if it contributed to the discrimination, perhaps by honoring a client's discriminatory requests, or if it knew or should have known of the discrimination and failed to take prompt and corrective measures within its control, like ensuring that the client is aware of the misconduct, insisting on an investigation or other corrective measure, and offering a worker a different assignment.

To determine, for purposes of potential liability under federal anti-discrimination laws, when a leased employee is an employee of a third-party staffing agency or the company using the worker's service, the EEOC creates a two-part inquiry:

1. Is the worker an employee or an independent contractor?

To determine the answer to this question, the EEOC directs employers to contemplate a list of factors, including the right to control when, where, and how the worker performs a job. This test, known as the common law agency test, is discussed in greater detail in Section II.

2. Which company employs the worker (the third-party staffing agency, the company using the worker's services, or both)?

The answer to this question will depend upon each employer's analysis of the common law factors that determine employee status. If each company has a right to control the worker and has the minimum number of employees required to fall under the jurisdiction of the anti-discrimination laws, then the companies will be covered as "joint employers."

Typically, both companies will qualify as employers. Staffing firms "generally qualify" as employers because such firms tend to hire the worker, determine when and where the worker works, have the right to discharge the worker, and pay the worker, deducting applicable taxes. A client of an employment agency also frequently qualifies as an employer of a worker assigned to the company because the it usually exercises supervisory control over the worker.

Even if a staffing firm or its client is not the worker's employer it can be liable for unlawfully discriminating against the worker. The anti-discrimination statutes not only prohibit an employer from discriminating against its own employees, but also prohibit an employer from interfering with an individual's employment opportunities.

If a staffing agency or a company that contracts for a worker's services is found to have engaged in unlawful discrimination, that company may be liable for back pay and front pay, and compensatory and punitive damages. If both companies are found to have discriminated, both companies may be held jointly and severally liable. The EEOC's position is that punitive and compensatory damages are assessed against each company according to its degree of malicious or reckless misconduct.

The EEOC advises staffing agencies not to send other workers to a work site if it learns that a client has discriminated against a temporary employee, unless the client has taken the necessary corrective and preventive measures to ensure that the discrimination will not recur. Otherwise, in the EEOC's view, the staffing firm is liable along with the client if a worker later assigned to the client is subjected to similar misconduct.

Note: Companies should be aware that leased or contract employees may count toward the minimum jurisdictional threshold under federal anti-discrimination laws. Both Title VII and the ADA apply to employers with fifteen or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year; the ADEA to employers with twenty or more employees. To determine coverage, the EEOC takes the position that a company must count every individual with whom the company has an employment relationship. Thus, a staffing agency's permanent staff and workers to assign out tend to bring such agencies within the laws' coverage.

Counting employees of companies who use the services of leased or contract employees may prove to be slightly more difficult. The EEOC has implemented a U.S. Supreme Court decision, ***Walters v. Metropolitan Educ. Enters.***, 519 U.S. 202 (1997), to count *any* employee with whom the employer had an employment relationship from the day the relationship began to the day it ended, whether the employee was at work or on leave each working day during that period. This may cause an employer to acquire more employees than it may consider itself to have; e.g., where an employee is on a long leave and the employer hires a temporary worker to replace the employee, the employee and worker might each count toward coverage. Because such matters may be complicated, if the issue of coverage arises, employers should consult with counsel to determine which individuals will count.

F. Americans with Disabilities Act

Under the ADA, employers and employment agencies are prohibited from discriminating against qualified job applicants or employees who are disabled with respect to job applications, hiring, advancement, discharge, compensation, training, and other terms, conditions, and privileges of employment. Staffing agencies may have liability either as an "employment agency" or "agent of the employer" without having been found to be an "employer" under a common law type analysis.

The ADA also requires employers to make reasonable accommodations to employees and job applicants who meet the definition of a qualified individual with a disability. Depending on the relationship with a temporary or leased employee, a company may find itself in a position of being obligated to reasonably accommodate a worker or of being held liable, perhaps jointly with a staffing agency, for a failure to accommodate an individual. The reasonable accommodation process requires employers to engage in an interactive process with employees to determine the most appropriate reasonable accommodation. Whether a company receiving the services of a temporary or leased employee, or the third-party staffing agency is engaged in such a process with an employee, the two entities may need to communicate with each other about the logistics of viable accommodations.

One potentially complicated accommodation is leave. Under the ADA, an employer may have to hold open an employee's job for the duration of any such leave as a reasonable accommodation, unless holding the job open would impose an undue hardship. In practice, a company using the services of temporary, leased, or contract employee may be required to recognize an individual's leave and return any such individual to work. Temporary staffing agencies and their client companies may wish to work through complicated accommodation issues with legal counsel who can separately determine each company's responsibilities and potential liabilities.

G. Sexual Harassment

The Supreme Court's decisions in ***Burlington Indus. v. Ellerth***, 524 U.S. 742 (1998) and ***Faragher v. City of Boca Raton***, 524 U.S. 775 (1998), reshaped an employer's liability for sexual harassment. These decisions did not alter a staffing agency's liability for sexual harassment of an employee by a client. A staffing agency is only liable for harassment where it knew or should have known of the harassment and failed to take corrective action. The ***Ellerth/Faragher*** standard of liability is, however, important to the companies who use the services of a staffing agency. These companies should be aware that where a temporary or leased worker qualifies as a common law employee, the structure of the relationship is such that a company can be held automatically liable for sexual harassment against that individual. A company may be liable for the sexual harassment of a supervisor that results in a tangible employment action, or for harassment by a co-worker where the company knew or should have known of the harassment.

The EEOC, in its **Guidance on Vicarious Employer Liability for Unlawful Harassment by Supervisors**, defines supervisor broadly to include both individuals who have the authority to undertake or recommend tangible employment decisions affecting the employee and individuals who have the authority to direct the employee's daily work activities. The latter understanding of a supervisor means more than simply relaying other officials' instructions regarding work assignments and reporting back to other officials. Since the right to control is one factor in determining employee status as well as determining supervisory control over an individual for purposes of sexual harassment liability, to quantify its potential liability for sexual harassment, a company should analyze its relationship with temporary, leased, or contract workers to determine whether these individuals may qualify as employees.

The Supreme Court created an affirmative defense for companies where harassment does not result in a tangible employment action. One facet of the affirmative defense is an employer's reasonable care to prevent and promptly correct any harassing behavior. An employer's efforts to train supervisors and employees on the employer's sexual harassment policy may evidence reasonable efforts to prevent such behavior. Companies should, therefore, include contractors, vendors, and other third parties under its policy and should ensure that everyone in the workplace understands that no sexual harassment will be tolerated by or against anyone, including people who may only be in the workplace temporarily.

In addition, the EEOC notes that companies may be liable for harassment by a temporary, leased, or contract worker if management knew or should have known of the misconduct and failed to take prompt and appropriate corrective action. Therefore, a company should train managers and supervisors in responding to an employee's allegations of sexual harassment by or against an employee of a third-party staffing agency. The liability risks that attach to an inadequate response to investigation are too great for companies to be insufficiently prepared to respond to a complaint. Both staffing agencies and companies using such services will want to clarify and communicate to a temporary, leased, or contract worker what procedures exist for bringing an allegation of sexual harassment to the attention of the staffing agency, the client company, or both entities, and the steps that either or both may take to investigate and remedy such complaints. The two companies may then wish to communicate their sexual harassment complaint and correction procedures to one another, including how they would coordinate a response to the harassment with the other company.

H. Federal Wage And Hour Laws

The FLSA defines "employee" very broadly to include individuals who are suffered or permitted to work. The courts have construed an "economic reality" test to determine whether an employment relationship exists that may obligate a company for minimum wage, overtime, and equal pay obligations of the FLSA.

In the context of related companies who share the services of an employee, courts have adopted a "joint employer" concept to allocate responsibility for overtime compensation to shared employees. A joint employment relationship may be found when a worker performs work which simultaneously benefits two or more employers, or works for two or more employers during a work week.

The DOL has issued regulations that list the factors that may be determinative of a joint employment relationship. A joint employment relationship will exist if either employer acts directly or indirectly in the interest of the other employer concerning the employee; two employers agree to share an employee's services or interchange employees; or employers are not completely disassociated with respect to employment of a particular employee, but instead share control because one employer is controlled by the other employer.

The DOL typically considers employees performing services through third party vendors as the joint employee of both the provider and the recipient company. However, the DOL has stated that the company receiving the services is liable for overtime only if the temporary worker worked more than 40 hours in a work week for that company.

Employers and joint employers may be liable for overtime compensation, minimum wages, and compliance with the Act's record keeping requirements and child labor restrictions. Remedies include back wages, liquidated damages equal to the amount owed due to non-compliance with the FLSA, civil penalties of up to $1,000 per occurrence for repeat or willful violations, injunctions, criminal penalties (in cases brought by the DOL), and attorneys' fees (in private suits).

On June 11, 2007, the Supreme Court unanimously ruled that federal minimum wage and overtime laws do not apply to home care workers employed by third-party vendors. Affirming the DOL's regulatory process in ***Long Island Care at Home v. Coke,*** 127 S. Ct. 2339 (2007), the Court rejected a immigrant home health care worker's challenge to DOL regulations that exempt home health care workers employed by third-party agencies from FLSA overtime and wage floor requirements. A 1974 FLSA amendment specifically exempted from FLSA rules home care workers such as healthcare attendants and companions employed directly by the family they work for. A question left open by the 1974 amendment was whether the exemption also applied to homecare workers employed by agencies. Following a vetting process, the DOL issued interpretative regulations providing that third-party workers are exempt from the minimum wage requirement. Reversing the Court of Appeals for the Second Circuit, the Supreme Court declared the third-party regulation to be binding, and further, a valid exercise by the agency to "fill any gap" left by Congress in implementing the statute.

I. Family And Medical Leave Act

A company's obligations under the Family and Medical Leave Act (FMLA), which grants employees the right to take up to twelve weeks of unpaid leave for a serious health condition or birth, adoption or placement of a child in foster care, may be affected in three regards by temporary or leased workers:

1) The FMLA specifically provides that employees jointly employed by two employers must be counted by both employers for the purpose of determining employer eligibility. Employees from a temporary agency whom a company reasonably expects to continue using will count toward that company's coverage, and those employees will, naturally, count toward the staffing agency's coverage under the FMLA. The FMLA applies to employers with fifty or more employees within seventy-five miles for twenty or more weeks during the previous year.

2) The determination that an employee is eligible for FMLA leave is a two-part analysis that first asks whether the employer is subject to the FMLA and next asks if an employee is eligible under the FMLA. Part of the determination of an employee's eligibility for FMLA leave is the requirement that an employee work at least 1,250 hours in a twelve-month period. A temporary or leased employee's eligibility for leave will be determined by looking to the employment relationship with the individual's primary employer, the staffing agency, not by looking to a placement with a client. Without knowing whether a temporary, leased, or contract worker is eligible for leave, a company using the services of such an individual may still be obligated to recognize FMLA leave granted by the staffing agency, as discussed below. In addition, if an employee has worked for a company as a temporary worker and is hired on permanently, the hours worked as a temporary worker will count toward the 1,250-hour threshold.

3) The FMLA divides employers into two categories–primary and secondary employers. The primary employer (the staffing agency) is responsible for giving eligible employees required notices to employees, providing leave, maintaining health benefits, and restoring the employee to the same or similar job. Secondary employers (the employer using the temporary employee's services) are prohibited from interfering with an employee's exercise of FMLA rights. In the situation, for example, of a temporary worker who takes an FMLA-protected leave, the

secondary employer must accept the worker returning from FMLA leave, that is reinstate the worker to the same or a similar position, where the company is still using temporary employees from the temporary agency and the agency sends the employee returning from leave to the company.

A company's liability for violating the FMLA may be lost wages and benefits or, where no tangible loss has occurred, any other actual monetary losses (*i.e.*, the cost of providing substitute care), up to the equivalent of twelve weeks of pay. An additional equal amount is also recoverable as liquidated damages unless the employer can show it had reasonable grounds to believe its actions were not unlawful. An employee can also recover other equitable relief (*e.g.*, reinstatement, promotion) as well as prejudgment interest, attorney's fees, expert witness fees and other costs. Where two companies qualify as joint employers under the FLSA definition of the term (where a leased or temporary employee performs work that simultaneously benefits two employers, or where an employee works for two or more employers at different times during the week per agreement between the employers), the companies may be jointly and severally liable for violations of the FMLA.

J. Employee Benefits

Under ERISA, a company may be required to permit temporary or leased workers to participate in the company's benefits plans, where those workers qualify as employees. Traditionally under ERISA, whether an individual is an employee has been determined under the common law test.

Even if an employee of a staffing agency does not qualify as an employee, a worker may be a "leased employee" for certain important purposes. The legal concept of a leased employee is a creation of the tax code for the purpose of determining whether employee benefit plans (generally, qualified retirement plans, group life, and cafeteria plans) satisfy the Code's minimum coverage and nondiscrimination requirements. Under Section 414(n) of the Code, a worker is a leased employee if the individual is not a common law employee and (1) the individual provides services to a "recipient organization" pursuant to an agreement between the recipient organization and a leasing organization; (2) the services are performed for the recipient organization by the individual on substantially a full-time basis for at least a year; and (3) the services are performed under the primary direction and control of the recipient organization. Thus, workers who meet this definition may count as employees entitled to benefits under the plans subject to Section 414.

The litigation over benefits allegedly denied unlawfully has been one of the greatest risks for employers in using temporary, leased, or contract workers. As the litigation involving Microsoft has demonstrated, the consequences of misclassifying these workers can be great. The lesson learned from the Microsoft litigation is that liability for benefits is a serious matter. The U.S. Supreme Court twice refused to intervene in the litigation and to grant review of various matters.

K. The National Labor Relations Act

Under the NLRA, employees have protected rights to self-organization for the purpose of selecting an exclusive bargaining representative and to engage in other protected concerted activity affecting employees' rights as employees. While independent contractors are specifically excluded from the definition of employee, the term otherwise encompasses "any employee," including employees whose employment is not fixed or regular day-to-day, week-to-week, or even month-to-month employment.

Thus, temporary or leased employees may be protected for engaging in protected activity, however, these workers are generally not eligible to vote in union or certification elections with a client company's work force, unless these workers have a reasonable expectation of reemployment with the client and there is a sufficient community of interest between the temporary or leased worker and the client's workers or there is a history of recognizing such employees in the bargaining unit. Usually, a temporary or leased worker will not be eligible to vote if the worker knows that a job will only last a few months with no possibility of permanent employment or has been told that employment will end as of a fixed termination date. The eligibility of on-call employees to vote in a union election is determined under somewhat different standards.

The NLRB has now taken on the increasingly widespread use of contract and temporary employment. In a major decision involving temporary workers supplied by a staffing firm, ***H.S. Care L.L.C., d/b/a Oakwood Care Center,*** 343 N.L.R.B. No 76 (2004), the NLRB overturned its four-year precedent and ruled that both the staffing agency and the user employer (which uses the temporary employees) must consent before the Board will allow a representation election in a bargaining unit consisting of both jointly employed temporary workers and regular workers employed solely by the user employer. The Board's troublesome precedent in ***M.B. Sturgis,*** 331 N.L.R.B 1298 (2000), opened the door for jointly employed "temporary" employees to be grouped with a company's regular employees for purposes of bargaining. The Board's decision in the prior two consolidated cases -- ***M.B. Sturgis, Inc. (Sturgis)*** **and** ***Jeffboat Division, American Commercial Marine Service Co.*** **(*Jeffboat)***, 331 N.L.R.B. 1298 (2000) (collectively, "*Sturgis"*) – concluded that it was permissible, without employer consent, to have a bargaining unit combining both temporary workers employed by a vendor employer and a user employee with regular workers employed by the user employer. Left intact, the ***Sturgis*** ruling would have fundamentally changed the way in which contract or temporary employees may be organized. In some situations, under the Board's old approach, temporary employees could ostensibly even become covered by a company's preexisting labor agreement without an election (based on the Board's "accretion" doctrine).

Thus, even where a "supplier" employer (the company providing temporary employees) and a "user" employer both object to the inclusion of temporary employees into a "regular employee" bargaining unit, this will not prevent the creation of a combined bargaining unit. And an even more dramatic change would concern the manner in which bargaining would take place -- “supplier” and “user” employees may be required to engage in joint bargaining, with each entity being responsible for different aspects of the matters under negotiation.

Overruling ***Sturgis’*** approach, The Board majority in ***Oakwood Care Center*** concluded that ***Sturgis*** was “wrongly decided” for fundamental reasons; foremost being that the ***Sturgis*** Board misinterpreted the statutory concept of “employer unit.” The legislative text of the NLRA, it said, has not authorized the Board to direct elections in bargaining units encompassing employees of more than one employer. Although the Supreme Court has approved the practice of multi-employer units with the consent of the employer, such consent was not obtained in this case. Explaining its reconsideration of ***Sturgis,*** the ***Oakwood*** Board distinguished between a joint employer – comprised of two or more employers that co-determine essential terms and conditions of employment for unit employees – and a multiemployer. In the case of a joint employer, all of the unit employees work for a single employer, i.e., the joint employer entity A-B. Thus a joint employer unit of A-B is not a multiemployer.

In contrast, in the cases of ***Sturgis*** and ***Oakwood***, some of the employees were employed by A (the user employer) and some by A-B (both the user employer and the staffing agency). Under these terms, the terms and conditions of employment are set by A for some employees and by A-B for other employees. Thus, the entity that both groups look to as their employer is not the same. By ignoring the statutory directives of Section 9(b) as well as decades of its own precedent, the Board in ***Sturgis*** overstepped the bright line between employer and multiemployer units, the majority stated in ***Oakwood.*** Returning to its pre-***Sturgis*** principles, the NLRB concluded that solely employed employees and their jointly employed employees are employees of different employers and that their inclusion in the same bargaining unit creates a multi-employer unit.

Further, sound national labor policy required restoration of the basic principle that “employees be grouped together by common interests *and* by a common employer,” the Board majority stated. The ***Oakwood*** Board found that nonconsensual mixing of employees of different employers violated that basic principle.

In addition, employers of workers are subject to the NLRA’s duty to bargain with the employees’ representative and can be subject to unfair labor practices charges. A staffing agency and client company may be considered joint employers under the NLRA and considered jointly liable for violations of the NLRA, for example, where the agency refers and negotiates and pays the wages of a worker, while the client retains the ability to reject referrals, control work assignments and discipline, and retain substantial control over day-to-day work activities. Remedies include back wages owing, interest, and injunctive relief.

L. Occupational Health And Safety Act

Under the Occupational Health and Safety Act (“OSHA”), which requires employers to maintain a safe and healthy workplace, the party in direct control of the workplace and actions of a temporary or leased employee is generally liable for any violations of OSHA. A staffing agency may be cited for a violation of OSHA if it knew or should have known of an unsafe condition. Client companies are also required to include temporary workers in its required records of illnesses and injuries and train those employees, it directs and controls. Most employers may also be required to provide all necessary safety equipment.

M. Immigration Reform and Control Act

Companies using the services of a worker through a third-party vendor have no obligation to verify the worker's employment status.

N. Federal Taxes

An employer must deduct and withhold federal income tax from the wages that it pays to its common law employees. An employer is liable for the amount of income tax required to be deducted and withheld, even if the tax is not collected from the employee. However, if the employee later pays the tax, the employer's liability will be reduced by the amount paid by the employee, although the employer may still be liable for interest and penalties.

The general rule has been that the person who pays wages is responsible for employer tax and withholding. However, more recently, several courts have held that a co-employer of services received from a leased employee company is also liable, together with the leasing company, for the payment of withholding and FICA taxes relating to workers leased from the third party.

The FICA tax on employees and employers is measured by the amount of wages paid to the employee. FICA tax is comprised of two components, old age, survivor and disability insurance (Social Security) and hospital insurance (Medicare). Employers are required to deduct and withhold the employee portion, and to pay the employer portion, of FICA tax. An employer is liable for the entire amount of FICA tax required to be paid, even if the employee portion was not collected from the employee and even if the employee pays the tax directly.

O. Other Rights And Responsibilities

Companies that obtain the services of temporary or leased employees should also be aware that those individuals may have a right to access and inspect the client company's files in certain circumstances. For example, the Washington Department of Labor and Industries has ruled that Microsoft is a co-employer of its temporary staff and workers and that those workers have a right to view their evaluations and supervisors' comments in personnel records kept by Microsoft.

In addition, companies that use the services of a staffing agency should review with an attorney, what their record keeping obligations might be under various employment laws.

P. Minimizing Legal Risks of Alternative Work Arrangements

By following a few basic guidelines, companies can help to minimize the risks that they may be found to be joint employers of employees of third-party staffing agencies and may reduce legal liability:

1) Do provide employees with training regarding their interactions with non-employee workers. Ensure that employees understand that they should not treat these workers as employees of their company. Similarly, ensure that employees understand what protections these workers do have under the company's policies, particularly the company's anti-harassment policy.

2) Contemplate having the staffing agency supervise its employees who are assigned to your operations.

3) Do not mandate that the service provider follow specified hiring and training procedures.

4) Do not get involved in the selection or termination of the service provider's employees.

5) Do review the contract being offered by the service provider with legal counsel before entering into it. Review indemnification language. Also review the contract's language regarding employment obligations and liabilities.

6) Do attempt to have the service provider ask its employees to acknowledge that they are not going to be receiving any of your company's benefits as a result of performing services for it.

7) Do attempt to structure the contract with the service provider as a results-oriented agreement. By that, define the results to be obtained by objectives measures of performance. For example, do not tell a vendor how many people to provide for the work to be performed. Simply describe the work that needs to be done. In addition, do attempt to structure the payments to be made to the service provider on other than a "cost plus" basis. Instead attempt to build in a risk of loss or opportunity for profit into the relationship.

8) Do determine if it is feasible for the service provider to perform the services off of your premises.

9) Do review your employee benefit plans and all of your employment policies. Do determine whether or not they contain appropriate language that excludes the service provider's employees if you do not intend to offer them these benefits.