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MANAGING CONTINGENT WORKFORCE ISSUES

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THIS OUTLINE IS MEANT TO ASSIST IN A GENERAL UNDERSTANDING OF THE CURRENT LAW RELATING TO CONTINGENT WORKFORCE ISSUES. IT IS NOT TO BE REGARDED AS LEGAL ADVICE. COMPANIES OR INDIVIDUALS WITH PARTICULAR QUESTIONS SHOULD SEEK ADVICE OF COUNSEL.

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I. INTRODUCTION

A. Why Is This Topic Important?

Workers may be classified in one of two basic legal categories: employees or independent contractors.¹ Telling the difference between the two is both at once fundamental to the application of “employment” law and exceedingly complex. As the United States Supreme Court had occasion to note over 60 years ago:

“Few problems in the law have given greater variety of application and conflict in results than the cases arising in the borderland between what is clearly an employer-employee relationship, and what is clearly one of independent entrepreneurial dealing.” N.L.R.B. v. Hearst Publications, 322 U.S. 111, 121 (1944), reh’g denied, 322 U.S. 769 (1944).

And nothing has changed in those almost 70 years to make this “line drawing” problem any easier.

Each (literally) employment law statute contains its own unique definition of the term “employee.” Indeed, a “worker” (neutral term) may be an “employee” for the purpose of one statute while simultaneously, on the same facts, be an “independent contractor” for the purpose of a second statute.

In most circumstances, employers will benefit from an “independent contractor” rather than “employee” classification. As discussed below, however, in intellectual property ownership disputes, however, characterizing a “worker” as an “employee” is typically more beneficial to the employer. And in the wage-hour context, costs and penalties for overtime not paid to workers found to be “employees” and not “independent contractors” can be expensive “surprises.”

Courts and agencies have developed various legal tests to determine whether an individual is an independent contractor or an employee. There are at least four identifiable tests:

- (1) The common law test;
- (2) The economic realities test;
- (3) The hybrid test; and
- (4) The remedial legislation test.

Which test a court will apply depends on the context of the inquiry. We discuss below the substance of each of these tests and describe the various contexts in which courts will apply

¹ We do not discuss here “sole proprietors,” “partnerships,” “corporations,” “Limited Liability Partnerships” or “Joint Ventures.” Questions may also arise concerning the employment status of an individual who “volunteers” his/her services without requesting compensation. Generally, a bona fide volunteer is not an employee; the intent of the parties is controlling. However, the law recognizes very few true volunteers as to private sector employers. It is generally the case that a worker who offers to work without compensation for the purpose of gaining experience in an occupation is deemed to be an employee, not a volunteer.

them. The sheer number of tests, coupled with their complexity, demands vigilance by employers to assess their workers, and to be constantly aware of the changes to and variations in the tests.

Moreover, employers have and will continue to be affected by both statutory amendments (in California and Massachusetts, in particular) and decisional authority extending protection from harassment and discrimination to independent contractors, in addition to traditional “employees.” Independent contractors also enjoy strong support from an organizational standpoint, as several organizations have emerged in recent years whose aim is to advance and protect the rights of temporary workers to enjoy the same terms and conditions of employment as traditional employees.² Beyond these changes, employers are also faced with difficult assessments of employees versus independent contractors for purposes of taxes, wages and benefits, a point dramatically illustrated in a series of rulings against Microsoft and in favor of its “permatemps” (to the tune of nearly \$100 million).

B. “Employment” Status Beneficial To Prove “Work for Hire”

Circumstances exist in which a company may affirmatively wish to characterize a worker as an “employee,” as noted above, rather than an “independent contractor.” For example, a company may wish to avoid alleged tort liability for injuries it caused a worker and subject the claim to workers compensation coverage.

Across the country, too, those companies which have retained the services of workers who create intellectual property (such as freelance technical service workers—including drafters, computer programmers and website designers, for example) but which have failed to expressly agree in a written instrument the workers have signed agreeing that their work product will be considered a “work made for hire,” and/or who have not agreed to an “assignment of intellectual property rights,” have found it necessary to obtain copyright ownership for resulting creative work product by proving up an employment relationship. Proving up such an employment relationship may have “profound significance” to permit a company to protect its copyright to “work made for hire.” The United States Supreme Court so noted in Community for Creative Non-Violence, et al. v. Reid, 490 U.S. 730 (1989).

In Reid, the Court held that the Copyright Act of 1976 initially vests copyright ownership “in the author or authors of the work.” The Act carves out an exception, however, important to companies contracting for creative works (including website designs and content, for example) made for hire. If the work is “for hire,” the employer or other person for whom the worker prepared it is considered the “author” and owns the copyright (unless there is a specific contractor agreement to the contrary).

Moreover, the Court held that Section 101 of the Act provides that a creative work could be copyrightable “works for hire” under two sets of circumstances:

1. a work prepared by an employee within the scope of his or her employment; or

² The organization Working Partnerships USA developed a “Code of Conduct” aimed at temporary agencies, which sets forth guidelines regarding hiring and treatment of employees of these agencies.

2. a work specially ordered or commissioned for use as a contribution to a collective work, as part of a motion picture or other audio visual work, as a translation text, as a test, as answer material for a test, or as an atlas, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire.³

Accordingly, in the absence of an express [probably written] agreement vesting ownership of an independent contractor's creative work in the company, the employer must prove that the employee prepared the work within the scope of his or her employment, or else forfeit ownership. In such a "work made for hire" situation, characterizing a worker as an independent contractor would work against the company's intellectual property ownership interests.

Employers with independent contractors in California face a policy decision: they can either (a) forfeit any intellectual property the Independent Contractor develops for the employer (see the Reid case decision, discussed above); or (b) cause ownership of any intellectual property to run to the employer by installing a "work for hire" clause in the independent contractor's service agreement (see discussion below); or (c) "assign" ownership of any intellectual property to the employer by causing the independent contractor to sign an "assignment agreement" with the employer (although there are disadvantages to this approach of concern to intellectual property lawyers and beyond the scope of discussion of this paper).

The concern many IP lawyers have with Option b, above--to install a "work for hire" clause in an Independent Contractor service agreement for a California IC--is that it will doom the host client company receiving the service to the burdens of "employee" status by virtue of Labor Code Section 3351.5(c). This section simply converts an independent contractor signing a "work-for-hire" clause into an "employee", but only for the purposes of workers compensation, and not, apparently, for any other employment law purpose. (Section 3351.5 is part of the definitions section of that part of the California Labor Code which gives "employees" the protection of workers compensation coverage). Different clients will disagree over the amount of concern to attach to this result, depending upon what the client values and what it fears.

If the client prizes protection of intellectual property, and does not fear a potential conclusion that the "worker" will be found to be an "employee" for workers compensation purposes, then the company will want to exercise its discretion to include the "work for hire clause" in the independent contractor's service contract. If your client does not wish to absorb

³ In California (and in many other states) for purposes of workers compensation and unemployment compensation, an employee is defined as a person engaged by contract for the creation of a "specially ordered or commissioned work of authorship," when the parties expressly agree in a written instrument that the work shall be considered a "work made for hire." See, e.g., Cal. Lab. Code § 3351.5 & Cal. Unemp. Ins. Code § 686. Accordingly, employers have an election to make. If the employer elects not to employ the worker with whom the employer is contracting to provide the needed service, but rather renders the worker an "independent contractor" whose work product the company will own by contract as a "work made for hire," the worker will become an "employee" for purposes of workers and unemployment compensation, even if not for other statutes and contract entitlements. However, prudent employers will want to specifically clarify--by contract--the worker's status, and establish that he or she does or does not enjoy "employee" status triggering various other statutory and contract entitlements beyond workers' compensation coverage. Moreover, the employer will still need to "manage the relationship" to ensure that it does not in fact control the worker to the point of converting him or her to an "employee" in fact for purposes beyond workers and unemployment compensation.

the risk of worker's compensation coverage, then it should not include the work for hire clause in the Independent Contractor's service agreement and should find alternative ways to cause the Independent Contractor's work product to become your client's intellectual property.

C. The Government is Attacking Use of Independent Contractors

Use of independent contractors is generally attributed to corporate concerns about rising employee benefits costs; the desire for increased personnel flexibility and expertise; protection of regular "core" employees from lay-off and worker demands for greater flexibility to work part-time, intermittently or at home. Federal and state agencies are examining independent contractor relationships more closely to see if these workers are, in fact, employees.⁴ The essence of the work relationship governs and not the characterization of the relationship by the parties.

Indeed, the Supreme Court of California handed down a broadly worded opinion (discussed below) expanding the legal definition of the term employee for the purpose of California's Unemployment Insurance, and perhaps other "remedial" statutes designed to protect workers. S.G. Borello & Sons v. Department of Industrial Relations, 48 Cal. 3d 341 (1989).

Apart from governmental agencies, plaintiffs bringing private causes of action, particularly wrongful discharge and employment discrimination suits, have also sought to prove they are protected "employees." Since January 1, 2000, workers in California, for example, have found it much easier to challenge employment harassment without having to prove they are a traditional "employee." An amendment to California's Fair Employment and Housing Act ("FEHA") now makes it unlawful for an employer, or its employees, to harass an independent contractor (specifically, "a person providing services pursuant to a contract") because of that person's race, religious creed, color, national origin, ancestry, physical disability, mental disability, medical condition, marital status, sex, or age. Cal. Gov't. Code § 12940(j)(1).⁵

In practice, companies often characterize "independent contractors" in many different ways. They may be called "contractors," "consultants," "temps," "vendors," "contract workers" or "leased" employees, among other things. Currently, many companies retain independent contractors for a specific project, by the day or the week or indefinitely. Some companies restrict independent contractors to clerical or blue-collar positions. Other companies use contractors throughout the organization, including in recent years, in a variety of professional positions all the way up to and including the Chief Executive Officer.

⁴ These agencies include, but are not limited to, the federal Internal Revenue Service ("IRS"), the U.S. Citizenship and Immigration Services ("USCIS"), (formerly the Immigration and Naturalization Service), National Labor Relations Board ("NLRB"), Equal Employment Opportunity Commission ("EEOC"), Department of Labor ("DOL") and state agencies responsible for unemployment taxes and benefits, state taxation, antidiscrimination, wage-hour laws and workers' compensation statutes.

⁵ As amended, FEHA provides a three-part test to classify contract workers. "A person providing services pursuant to a contract" is a person who meets all of the following criteria: (1) the person has the right to control the performance of the contract for services and discretion as to the manner of performance; (2) the person is customarily engaged in an independently established business; and (3) the person has control over the time and place the work is performed, supplies the tools and instruments used in the work, and performs work that requires a particular skill not ordinarily used in the course of the employer's work. Cal. Gov't. Code § 12940(j)(5).

Current practice finds some contractors paid on a project basis, i.e., a set fee for services, while others are paid a rate based on the amount of time they perform services, either hourly, daily or weekly. Although contractors ideally have their own facilities, tools and equipment, in many cases they work on company premises, side by side with employees.

D. Protection Of Employees From Non-Employee Harassment Now Firmly Embedded In California’s Fair Employment And Housing Act (“FEHA”).

Effective January 1, 2004, California’s FEHA first prohibited harassment of employees by independent contractors and other non-employees (including customers, vendors and the like). The amendment followed a California appellate court decision in Carter v. Dep’t of Veterans Affairs, 121 Cal. App.4th 840, 862 (2004), in which the court dismissed a nurse’s sexual harassment claim against her employer – a Veterans Hospital – because a patient who was not employed or otherwise affiliated with the hospital accomplished the harassment. In response to Carter, former Governor Davis signed into law an amendment to FEHA which expressly provided the employer is liable for harassment of employees by non-employees.

In light of the amendment to FEHA, employers must now watch for harassment inflicted by such independent contractors. Employers can and will face liability for such harassment if they learn of, and fail to take remedial action to prevent, the harassment.

Such theory of liability has been adopted beyond California as well. In Dunn v. Washington County Hospital, 429 F.3d 689 (7th Cir. 2005), the Seventh Circuit Court of Appeals reversed a trial court’s grant of summary judgment on behalf of the employer for the alleged discriminatory conduct of a physician independent contractor. Disputing the trial judge’s contention that the employer could not control the physician’s conduct as an independent contractor, the Seventh Circuit held that since liability is direct rather than derivative, it makes no difference whether the person whose acts were complained of was an employee, an independent contractor, or even a customer. Where an employer either intentionally creates, or tolerates, unequal working conditions, the employer may be liable for the actions of the offending individual.

E. Attachments

1. **Attachment A** provides a graphic view of the four major ways in which the independent contractor or employee relationship may typically present itself.
2. **Attachment B** provides a side-by-side four columned chart succinctly comparing the legal elements to determine whether a worker is an “employee” within the meaning of (a) the IRS Code; (b) California Common Law; (c) California Labor Code, (d) legal tests other courts have used; and (e) California’s Workers’ Compensation statute (the Borello “Bouillabaisse” test).
3. **Attachment C** provides a four columned chart identifying a number of possible risks employers face if they misclassify workers as independent contractors, the applicable enforcement agency, the legal test that agency applies and the possible penalties the employer faces if improper classification occurred.

4. **Attachment D** provides a detailed suggested form employers may use to audit their businesses to help assess the classification of their workers as either employees or independent contractors.

5. **Attachment E** is a model Independent Contractor Agreement form.

II. HOW TO DETERMINE WHETHER YOUR INDEPENDENT CONTRACTORS ARE REALLY YOUR EMPLOYEES

No “bright-line” legal tests are available to determine whether a person performing work is an “independent contractor” or an “employee.” Unfortunately, there is no one single homogenous definition of the term “employee” applicable to all federal and state statutes and legal causes of action. Indeed, recent legal decisions in California and across the country suggest that increasingly fragmented definitions of the term “employee” are emerging.

In summary, the legal tests for employment status increasingly vary depending on the statute or regulatory scheme in question. No single factor or group of factors determines the outcome. Administrative agencies and the courts typically look to the totality of the circumstances and balance the factors to determine whether a worker is an employee. Many different statutes use the same factors, but the weight the courts give to any particular factor varies according to the public policy balancing unique to the statute in question. Case law is very fact specific.

Accordingly, it is difficult to make broad generalizations about the applicability of judicial decisions to specific situations. Rather, a careful customized analysis of the definition of the term “employee” as used in each employment statute is necessary to reach a confident conclusion of employment status.

In general, however, courts will find an employment relationship to exist if the employer “controls” the “process of work.” Conversely, in general, the Courts will find an independent contractor relationship to exist if the employer dictates only “the end result” of the work.

A. The Common Law Test: “Control/Right of Control”

Many statutes and regulations are based on the “common law” test. Under the common law test, the Courts will find an employment relationship if the employer exercises (a) “control” or (b) has the “right of control” over the individual’s performance of the job and how the individual accomplishes the job. The greater the control exercised over the terms and conditions of service, the greater the chance the Court will conclude the controlling entity is an employer of the at-issue worker. (Two entities, each exercising sufficient control over each other, may also be held to be a “joint employer,” as discussed more fully below).

The “right of control” test depends upon consideration of the following ten factors, (no one of which is dispositive), which may indicate independent contractor status:

1. the degree of “employer” control over the details of the work;⁶
2. whether the individual’s business is a distinct occupation or business;
3. whether the individual’s occupation usually is done without supervision;
4. whether a high level of skill is required by the occupation;
5. whether the worker provides the supplies, tools and the place of work;
6. the length of time the services are provided;
7. method of payment, by the job rather than the hour or day;
8. whether or not the work is part of the regular business of the employer;
9. whether the parties believe they are creating an independent contractor relationship; and
10. whether the hiring entity is not in business.

Restatement 2d, Agency, § 220 (1958). These factors rest on whether an individual exercises entrepreneurial discretion; if so, a court will find that the individual is an independent contractor.⁷ If not, then the company’s right to direct or control the means and manner of performing the work is dispositive regarding the existence of an employer-employee relationship, whether or not the right has been exercised.⁸

1. Employees: Right to Control Found

Justmed, Inc. v. Byce, 2010 U.S. App. LEXIS 6976 (9th Cir. April 5, 2010) [Common law test evidences that individual was an employee, and thus source code was a work for hire the business properly owned. The contemplated duration of the relationship, the tasks performed, and the fact Byce earned salary all supported finding that Byce was an employee, and that lack of control over the manner and means of production related more to function of job as a computer programmer for a start-up business].

⁶ Estate of Suskovich v. Anthem Health Plans of VA, Inc., 553 F.3d 559, 566 (7th Cir. 2009) [“Merely setting a work schedule is not sufficient to support a finding that a given person is an employee rather than an independent contractor”].

⁷ FedEx Home Delivery v. NLRB, 2009 U.S. App. LEXIS 8272 (D.C. Cir. 2009) [National Labor Relations Board found that employer failed to bargain with valid collective bargaining representative. However, the court found that drivers were actually independent contractors that could not unionize since the ability to operate multiple routes, hire additional drivers and helpers, and to sell routes without permission, as well as the parties’ intent expressed in their contract, argued strongly in favor of independent contractor status. Because the evidence supporting independent contractor status was more compelling under the court’s precedent, the Board’s determination was legally erroneous].

⁸ Zebley v. Heartland Indus. of Dawson, Inc., 2008 U.S. Dist. LEXIS 68823 at p. 16 (D. N.D. 2008) [citing Doan ex. rel. Doan v. City of Bismarck, 632 N.W.2d 815, 821-822 (N.D. 2001)].

2. Independent Contractors: Right to Control Not Found

Ruiz v. Affinity Logistics Corp., 2010 U.S. Dist. LEXIS 26765 (S.D. Cal. March 22, 2010) [Delivery drivers properly classified as independent contractors since: (1) drivers able to hire others to operate the trucks and perform the services they contracted to perform; (2) all the drivers established their own business prior to working for Affinity; (3) driver witnesses testified they had the ability to select their routes based on scores they received from customer surveys; and (4) any manuals or uniform rules were requested from Affinity's customer as opposed to Affinity].

B. The IRS Test

The Internal Revenue Service is concerned with determining whether a worker is an independent contractor because employers are required to pay three types of employment taxes for their "employees." These taxes are required under:

The Federal Insurance Contributions Act ("FICA") (29 U.S.C. § 3121(d)(2)), which governs employer and employee contributions to the Social Security system;

The Federal Unemployment Tax Act ("FUTA") (26 U.S.C. § 3306(i)), which governs employer contributions to the unemployment fund; and

The IRS rules governing employee personal income tax withholding (26 U.S.C. § 3401(c)).

If the employer categorizes independent contractors incorrectly, and the IRS determines that a worker is actually an employee, the employer may be liable for penalties as well as any unpaid taxes. Vizcaino v. Microsoft, 97 F.3d 1187, 1190-91 (9th Cir. 1996) (I.R.S. investigation resulted in reclassification of Microsoft's free-lance employees as common law employees subject to withholding taxes, FICA tax and overtime pay.)

The IRS test is essentially the common law test to which several "right of control" factors have been added.⁹ The resulting more detailed twenty (20) factors "are designed only as guides to determine whether an individual is an employee; special scrutiny is required to apply the 20 factors to assure that formalistic aspects of an arrangement designed to achieve a particular status do not obscure the substance of the arrangement." See Rev. Rul. 87-41.

The IRS factors include:

- 1) Whether the individual is required to follow instructions;
- 2) The amount of training of the individual related to that particular job;
- 3) The amount of integration of the individual into the employer's business;

⁹ **Attachment B** compares the IRS test, the common law test and two popular legal tests courts use to determine independent contractor status.

- 4) Whether services are rendered personally by the individual;
- 5) Whether the employer hires, fires and pays assistants;
- 6) The existence of a continuing relationship;
- 7) The establishment of a set amount of work hours;
- 8) Whether the individual must devote substantially full time to the job;
- 9) Whether the individual works on the employer's premises;
- 10) Whether the individual works according to a sequence set by the employer;
- 11) Whether the individual must submit regular or written reports to the employer;
- 12) Whether the individual is paid by time rather than by project;
- 13) Whether the individual is reimbursed for expenses;
- 14) Whether the individual furnishes the necessary tools and materials;
- 15) Whether the individual has invested in the facilities for performing the services;
- 16) Whether the individual can realize a profit or a loss;
- 17) Whether the individual works for more than one firm at a time;
- 18) Whether the individual makes his/her services available to the general public;
- 19) Whether the employer has the right to discharge the individual; and
- 20) Whether the individual has the right to terminate the relationship.

Although most courts continue to cite Rev. Rul. 87-41 as the seminal revenue ruling on this subject, the IRS, in a 1999 non-binding advice memorandum, stated that because of the difficulty inherent in applying the cumbersome 20-factor test, it has employed a new three-factor approach: (1) behavioral control (i.e. right to direct and control performance and the specific tasks); (2) financial control (right to direct and control the business aspects of the worker's activities); and (3) relationship of the parties (the parties' perception of their relationship, and their intent as to its permanency or lack thereof). IRS Chief Counsel Advice Memorandum, 1999 IRS CCA LEXIS 239; IRS CCA 199948001 (1999).

The courts have applied the IRS's "right of control" test in a variety of contexts. An important element often present in the case law where the courts have found "control" is the

ability of the employer to dictate not only the result, but also the process (or methods) the worker uses to produce his or her result.

1. Employees: Right to Control Found

Ewens & Miller, Inc. v. Comm’r, 117 T.C. 263 (2001) (Tax court affirmed IRS determination that taxpayer’s cash payroll workers, bakery workers, and outside sales workers were common law employees because employer exercised control and provided most of the facilities even though workers had the opportunity for profit or loss.)

Eren v. Commissioner of Internal Revenue, 180 F.3d 594 (4th Cir. 1999) (State Department architect who oversaw repairs to U.S. embassies throughout the world and who was bound by personal services contract, was an employee and therefore not entitled to a § 911 foreign earned income exclusion, where: (1) architect was required to follow Department’s project director handbook; (2) he maintained a daily log and submitted monthly progress reports; (3) he could hire and fire his own staff, but their contracts were entered into with and paid for by the Department; and (4) Department dictated his hours and leave).

United States v. Polk, 550 F.2d 566 (9th Cir. 1977) (Workers were employees based on the fact that management gave orders, supplied working materials, established working hours and retained the right to terminate workers).

Walker v. Altmeyer, 137 F.2d 531 (2d Cir. 1943) (Attorney-lessee who performed legal services for another attorney in exchange for office space was employee based on the lessor’s ability to control what attorney-lessee should do and how he should do it).

Chase Mfg., Inc. v. United States, 446 F. Supp. 698 (E.D.Mo. 1978) (Aluminum siding applicators were employees since employer retained sufficient control over work performance. The applicators worked exclusively for employer. They did not provide their own helpers and, if helpers were required, the employer provided assistants).

2. Independent Contractors: Right to Control Not Found

Sam v. U.S., 2002 U.S. Dist. LEXIS 24243 (D. Md. 2002) (Truck drivers of trucking business were independent contractors in that sole-proprietor exercised little control over them, did not provide a workplace and allowed them the opportunity to control their profits).

Ware v. U.S., 67 F.3d 574 (6th Cir. 1995) (AAA insurance agent found to be an independent contractor, and therefore entitled to deduct from his gross income certain unreimbursed business expenses not available to an employee, where agent: (1) received commissions only, (2) paid most of his business and travel expenses, (3) made a significant investment in the enterprise, and (4) may realize profit and is subject to a significant risk of loss).

Aparacor, Inc. v. U.S., 556 F.2d 1004 (Ct.Cl. 1977), opinion supplemented by 571 F.2d 552 (Ct.Cl. 1978) (Distributors of women’s clothing at neighborhood parties were not employees where no indicia of employment were present. Each distributor had his own clientele and controlled his own method of promoting and selling the clothes).

Tristate Developers Inc. v. U.S., 549 F.2d 190 (Ct.Cl. 1977) (Applicators in home improvement business were independent contractors based on lack of supervision, degree of skill, provision of own tools and freedom to hire helpers).

United States v. Aberdeen Aerie No. 24, 148 F.2d 655 (9th Cir. 1945) (Doctor was not an employee even though he was required to keep regular office hours).

In summary, the IRS tends to concentrate on the degree of control the employer may exert over the worker. In reaching a conclusion about control, the IRS weighs and balances the typically numerous facts unique to the case.

3. Consequences of Employment Status: Employer's Liability for Taxes, Penalties and Interest

a. Federal.

If independent contractors are reclassified as employees, the employer is liable for all unpaid income, FICA and FUTA taxes. I.R.C. §§ 3402, 3102, 3301. In such reclassification cases, however, the employer's federal tax penalty for failure to withhold income taxes is only 1.5 percent (3 percent if no information returns were filed) of the wages subject to income tax withholding; also, the employee social security tax penalty is 20 percent (40 percent where no information returns were filed) of the social security taxes required to be withheld. I.R.C. § 3509. The employer also remains nonetheless fully liable for the employer's portion of FICA and FUTA taxes at the regular rates. Moreover, the above-reduced rates do not apply to an employer's "intentional disregard of its withholding obligation."

In addition, any responsible person (including corporate officers and employees or members or employees of a partnership) with authority over the financial affairs of the business who willfully fails to collect and pay over taxes may be held personally liable for the total amount of the uncollected tax under the "100 percent penalty" provisions of the Internal Revenue Code. I.R.C. § 6672.

In "employee vs. independent contractor" controversies, the IRS will typically not only seek corporate financial penalties for failing to withhold employee taxes, but will also seek penalties section 6651(a)(1) imposes for failure to file a tax return. This penalty may be abated upon a showing of reasonable cause for the failure to file. The section 6656 penalty for failure to make a deposit of taxes will not be asserted if no tax was withheld. Rev. Rul. 75-191, C.B. 1975-1, 376. The employer is also liable for interest on unpaid taxes at the statutory rate. I.R.C. § 6601.

Section 530 of the 1978 Revenue Act provides an employer with relief from Federal employment taxes for certain individuals who the employer consistently did not treat as employees, unless the employer had no "reasonable basis" to treat these individuals as contractors. Under Section 530, a reasonable basis to treat a worker as an independent contractor is considered to exist if the taxpayer (1) reasonably relied on published rulings or judicial precedent, (2) reasonably relied on past IRS audit practice with respect to the taxpayer, or (3) reasonably relied on long-standing recognized practice of a significant segment of the industry of which the taxpayer is a member. NOTE: There is currently proposed legislation pending in the

U.S. House of Representatives which would clearly define the term “independent contractor” and, if passed, would likely render Section 530 unnecessary.

b. California.

In addition to liability for unpaid personal income, unemployment insurance and state disability insurance taxes, California imposes a 10 percent penalty on any employer which, without good cause, fails to pay any contributions required of it or its employees. Cal. Unemp. Ins. Code § 1112. In addition, employers are liable for interest at the adjusted annual rate on such unpaid contributions from the date of delinquency until paid. Cal. Unemp. Ins. Code § 1113. Under current practice, unpaid personal income tax is generally assessed at a rate of 6 percent of wages subject to withholding. If the personal income tax for which the employer is liable is paid or if the employee reports the wages to the Franchise Tax Board, the employer is relieved of liability for the tax itself but not for penalties or additions to the tax otherwise applicable in respect of the failure to deduct and withhold. Cal. Unemp. Ins. Code § 13071.

Even harsher penalties exist for employers related to misclassification of workers where fraud or willful misconduct occurs. Where the Employment Development Department of California determines in its issuance of a tax assessment that the employer willfully engaged in fraudulent behavior in misclassifying its workers, instead of a 10 percent penalty, the EDD has discretion to issue a 50 percent penalty. Cal. Unemp. Ins. Code § 1128(a). Furthermore, should the employer attempt to appeal the assessment without success and upon exhaustion of all appellate rights, once the assessment becomes final and unpaid, the EDD can issue a personal liability tax assessment against corporate officers or other individuals with the employer that failed to make payment on the assessment.

C. The Fair Labor Standards Act (FLSA) Test

The FLSA test provides a broader definition of employee than the common law.¹⁰ This is to ensure that courts effectuate the broad policies and intentions of Congress in passing the FLSA.¹¹ The FLSA governs the federal minimum wage and overtime pay obligations of many employers. 29 U.S.C. § 201. Employers cannot reduce these obligations merely by classifying workers as independent contractors.¹² If the U.S. Department of Labor determines that the workers are employees, the employer may be subject to substantial penalties, from the payment of unpaid overtime premiums to liquidated damages, fines of \$10,000 and six months’ imprisonment for willful violations. Unpaid overtime premiums alone may represent substantial monetary liability depending upon the size of the work force and the length of time the company has failed to pay appropriate overtime.

¹⁰ Estate of Suskovich v. Anthem Health Plans of VA., Inc., supra, 553 F.3d at 565 [citing Sec. of Labor v. Lauritzen, 835 F.2d 1529, 1534 (7th Cir. 1987)].

¹¹ Doe v. Cin-Lan, Inc., 2008 U.S. Dist. LEXIS 107802 at p. 18 (E.D. Mich. 2008) [quoting Donovan v. Brandel, 736 F.2d 1114, 1116 (6th Cir. 1984)].

¹² Crouch, et al. v. Guardian Angel Nursing, Inc., 2009 U.S. Dist. LEXIS 103831 at p. 15 (M.D. Tenn. 2009) [“. . .the existence of a contract, like the Independent Contractor Agreement signed by each of the Plaintiffs in this action and which purports to characterize Plaintiffs as independent contractors, is not dispositive of the question of whether an employment relationship exists, as ‘the FLSA is designed to defeat rather than implement contractual arrangements’”]. (Citation omitted).

The FLSA “economic realities” test focuses on whether an individual is economically dependent on the business to which services are provided, thus establishing employee status, or whether the worker effectively is in business for himself or herself. Unlike the IRS test, the FLSA’s “economic realities” test is usually determined by reference to six roughly equal factors:¹³

- 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.

See Speen v. Crown Clothing Corp., 102 F.3d 625 (1st Cir. 1996), cert. denied, 520 U.S. 1276 (1997); Doty v. Elias, 733 F.2d 720, 723 (10th Cir. 1984); Usery v. Pilgrim Equipment Co. Inc., 527 F.2d 1308, 1311 (5th Cir.), cert. denied, 429 U.S. 826 (1976).

It is well established that these factors cannot be considered in isolation. All circumstances of the work activity must be taken into account. Rutherford Food Corp. v. McComb, 331 U.S. 722 (1947), reh’g denied, 332 U.S. 785 (1947).

1. Employees: Economically Dependent

Heath v. Perdue Farms, Inc., 87 F. Supp. 2d 452 (D. Md. 2000) (Chicken catchers were employees of poultry processing plant where employer controlled every aspect of the chicken catchers’ work and where the chicken catchers had little opportunity to substantially increase their profits).

Baystate Alternative v. Reich, 163 F.3d 668 (1st Cir. 1998) (workers at temporary staffing agency were employees, where agency was solely responsible to hire workers, control work schedules, screen for qualifications, determine rate and method of payment, and where agency had the power to refuse to send workers back to a job site).

Baker v. Barnard Const., 146 F.3d 1214 (10th Cir. 1998) (rig welders were employees of general contractor for oil and natural gas pipelines where, despite fact that welders provided their own welding equipment, contractor controlled work hours and breaks, paid welders a fixed hourly rate, and did not ask welders to exercise discretion in applying their skills), but see Carrell

¹³ Some federal courts, however, have held that control is the determining factor. Holt v. Winpisinger, 811 F.2d 1532 (D.C.Cir. 1987); Blankenship v. Western Union Tel. Co., 161 F.2d 168 (4th Cir. 1947).

v. Sunland Const., Inc., 998 F.2d 330 (5th Cir. 1993) (rig welders for natural gas pipeline construction companies were independent contractors).

McLaughlin v. Seafood, Inc., 867 F.2d 875 (5th Cir. 1989) (Unskilled packers, pickers and peelers of crabmeat and crawfish found to be employees of a seafood processor. Economic reality, rather than the common law test, provides that frequent movement from plant to plant does not establish economic independence for mostly non-English speaking Vietnamese).

Patel v. Quality Inn South, 846 F.2d 700 (11th Cir. 1988), cert. denied, 489 U.S. 1011 (1989) (Undocumented aliens under Immigration Reform and Control Act are entitled to protections of the FLSA).

Brock v. Mr. W Fireworks, Inc., 814 F.2d 1042 (5th Cir.), cert. denied, 484 U.S. 924 (1987) (Operators of fireworks stands were employees based on: (1) the owner's control regarding location and size of stands, prices, merchandise sold, display of merchandise, the hours the operators must attend the stands, advertising and method of paying the operators; (2) the owner's control of opportunity for profit and loss; (3) the amount of investment made by the owner in the business; and (4) the absence of need for any particular skill for the job. As to permanency of employment, operators worked through the entire fireworks season. The court held that when an industry is seasonal, the proper test to determine permanency of the relationship is not whether the alleged employees returned from season to season, but whether the alleged employees worked for the entire operative period of a particular season).

Doty v. Elias, 733 F.2d 720 (10th Cir. 1984) (Waiters and waitresses working for tips at a steakhouse were employees where: (1) the restaurant essentially established work schedules by establishing the restaurant's business hours; the court did not consider an otherwise flexible work schedule sufficient to warrant independent contractor status; (2) the restaurant also exerted control by its ability to fire workers at will; (3) the waitpersons did not invest in the enterprise; (4) waiters and waitresses did not share in the profits or losses; and (5) waiting tables did not require specialized skills).

Castillo v. Givens, 704 F.2d 181 (5th Cir.), cert. denied, 464 U.S. 850 (1983) (Procurer and supervisor of cotton harvesting crew was an employee; therefore, crew members also were employees).

Donovan v. Sureway Cleaners, 656 F.2d 1368 (9th Cir. 1981) (Dry cleaner's "agents" were employees based on: (1) lack of control over pricing or location; (2) absence of investment; and (3) absence of sharing of business profits or losses. Their jobs also required little skill).

Marshall v. Truman Arnold Dist. Co., 640 F.2d 906 (8th Cir. 1981) (Operators of gasoline service stations under restrictive lease agreements with distributor were employees since: (1) the distributor controlled many of the details of running each station, e.g., hours of operation, prices to be charged, management of money, physical appearance of station; (2) the lessee provided only his/her labor or services; and (3) the risk of profit or loss was small since each lessee received a minimum guaranteed payment plus a small percentage commission on the amount of gasoline sold).

Donovan v. Tehco, Inc., 642 F.2d 141 (5th Cir. 1981) (Construction workers building, maintaining and rehabilitating gas service stations were “employees” since they: (1) had no other business organization; (2) with exception of hand tools, supplied only labor; and (3) supervised company employees and, in turn, were supervised by admitted company employees. Workers’ ability to choose job assignments, to elect hourly wages or payment by the job and to determine when work would be done were insufficient to counterbalance strong indicia of employee status).

Usery v. Pilgrim Equipment Co., Inc., 527 F.2d 1308 (5th Cir.), cert. denied, 429 U.S. 826 (1976) (Operators of laundry pick-up stations were employees when they were totally dependent on the company for direction and control, made no substantial investment and had no real opportunity for profit or loss).

Mednick v. Albert Enterprises, 508 F.2d 297 (5th Cir. 1975) (Hotel cardroom operator was an employee based on hotel’s provision of uniform, tools, equipment, menial skills and his economic dependence on hotel).

Thomas v. Brock, 810 F.2d 448 (4th Cir. 1987) (Economic realities test showed that local cookie and candy distributor was employee of seller since distributor was completely integrated into the seller’s business. He followed seller’s recommended prices on all but a few occasions, filed weekly reports on his sales and relied on the seller for bookkeeping. He worked solely for seller for three years and was prevented from competing with seller within 100 miles for a period of two years. He made little investment in the business. Although the distributor’s initiative was important in the success of his operations, his job did not require any special skills).

2. Independent Contractors: Not Economically Dependent

Catani v. Chiodi, 2001 U.S. Dist. LEXIS 17023 (D. Minn. 2001) (Staffing agency hired by steel manufacturer as intermediary when hiring back former employees was not an employer since it did not exercise any degree of control over persons alleged to be employees).

Donovan v. Brandel, 736 F.2d 1114 (6th Cir. 1984), reh’g, en banc, denied, 760 F.2d 126 (1985) (Pickers of cucumbers for pickling were independent contractors where: (1) the relationship with the cucumber farmer was temporary even though 40-50% of the harvesters return annually; (2) skill in tending the plant and judging when the fruit should be picked are required; (3) the lack of heavy capital investment was not determinative; (4) the workers’ participation in plant management provides an opportunity for profit or loss that is not solely a function of compensation by piecework; and (5) the demand for pickle harvesters led to the farmer’s relinquishment of daily control over the pickle growing operation. Court refused to find that agricultural workers always are employees.) NOTE: The California Supreme Court in a decision discussed below, dealt with essentially the same facts and came to the opposite conclusion. S.G. Borello & Sons v. Department of Industrial Relations, supra, 48 Cal. 3d 341.

Elizondo v. Podgorniak, 70 F. Supp. 2d 758 (E.D.Mich. 1999) (Distinguishing Brandel, supra, court found that pickers of cucumbers for pickling were employees of farm owners, where: (1) none of the plaintiffs had full-time jobs elsewhere or treated their work for defendants as supplemental; (2) fundamentals of picking could be learned in half a day, and, despite no

experience, plaintiffs picked a good yield in their first year, (3) plaintiffs' investment was limited to \$5 hoes, while defendant incurred over \$130,000 in equipment and harvesting expenses over two year period; (4) plaintiffs had no role in determining the price of pickles, and therefore had no opportunity to earn a "profit" on their work; (5) defendants assigned plots to workers, and otherwise retained significant control over their work; and (6) defendants provided free housing to plaintiffs (labor camps) and posted employment rights in the camps).

Bartels v. Birmingham, 329 U.S. 711 (1947) (Band leaders were independent contractors vis-à-vis hall operators based on their complete control over the musicians; by the same token, the musicians were employees of the band leaders).

Donovan v. DialAmerica Marketing, Inc., 757 F.2d 1376 (3d Cir.), cert. denied, 474 U.S. 919 (1985) (A telephone marketing firm hired two groups of workers: home researchers who performed telephone number research at home and who were employees; and distributors who recruited and supervised the home researchers).

The right of control factor weighed in favor of finding that the home researchers were independent contractors, but the circumstances as a whole supported a finding of employment. The decision determined that: (1) each home researcher worked for DialAmerica continuously and many worked for long periods of time; (2) the services rendered by home researchers were an integral part of DialAmerica's business; and (3) the home researchers were dependent on DialAmerica's business for their continued employment. The court held that whether the workers depended on the money they earned for obtaining the necessities of life was not relevant to the issue of economic dependence.

With respect to the distributors, the court found that they were independent contractors based on the following factors: (1) DialAmerica exercised little control over the distributors; they were permitted to recruit their own distributors and had the authority to set the rate at which their own distributors would be paid; (2) they risked higher financial loss if they did not manage their distribution network properly; (3) they paid for their own operating expenses; (4) their job required a special skill; and (5) the service rendered by the distributors was incidental and not an integral part of DialAmerica's business).

D. Massachusetts Statutory Test

Massachusetts is one of the few states with a distinct independent contractor statute. Under Massachusetts law, a worker will be considered an employee unless: (1) the individual is free from control and direction in connection with the performance of the service, both under his or her contract for the performance of service and in fact; (2) the service is performed outside the usual course of the business of the employer; **and** (3) the individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.¹⁴

The first element under Massachusetts law does not require a test so narrow as to require that the worker be entirely free from direction and control from outside sources.¹⁵ However, the statute is sufficiently stringent that the ability to set an individual's schedule and maintain the right to hire and fire at-will is sufficient to defeat independent contractor status.¹⁶ The second element requires an employer prove that the service performed is outside of its usual course of business.¹⁷ Finally, the third statutory prong requires analysis as to whether a worker is capable of performing the service to anyone wishing to avail themselves of the services and whether the nature of the business compels the worker to depend on a single employer for the continuation of the services.¹⁸

Improper classification of an individual as an independent contractor under Massachusetts' statutory law may result not only in an improper "windfall" to the employer through the avoidance of employee benefits, but also creates a significant financial burden on the state in lost tax and insurance revenues.¹⁹ This is why damages incurred as a result of a violation of the statute includes recovery not only of wages, but benefits the plaintiff can prove he or she was denied because of the misclassification, such as holiday pay, vacation pay, and other benefits to which he or she would have been entitled.²⁰ Employees can also recover attorneys' fees and treble damages under the statute.

E. California's Borello Test

California's approach to regulating employment differs considerably from that of the federal government, both in the breadth of California's coverage and the extent to which enforcement is achieved through assessment of penalties.²¹ California's wage-hour laws, set forth in the California Labor Code and the Industrial Welfare Orders, regulate time, place and manner of payment. While federal wage-hour requirements impose an economic realities test, California employers--until 1989--generally had to meet common law "right of control" tests to avoid costly confrontations with state wage and hour administrators. Whether the California

¹⁴ Mass. G. L. c. 149, §148B.

¹⁵ Athol Daily News v. Bd. Of Review of Employment and Training, 439 Mass. 171, 175 (2003) [interpreting G. L. c. 151A, § 2].

¹⁶ Chaves v. King Arthur's Lounge, Inc., 2009 Mass. Super. LEXIS 298 at p. 8 (2009).

¹⁷ Id. at p. 9.

¹⁸ Coverall North America, Inc. v. Commissioner of the Division of Unemployment Assistance, 447 Mass. 852, 858 (2006).

¹⁹ Somers v. Converged Access, Inc., 454 Mass. 582, 592-593 (2009).

²⁰ Id. at 594.

²¹ Martinez v. Transportation Management, LLC, 2008 U.S. Dist. LEXIS 96175 at p. 16-17 (C.D. Cal. 2008).

Supreme Court's decision in Borello will change this historical "right of control" standard remains an open question as we discuss below.

On March 23, 1989, the Supreme Court of California rejected long-standing application of the common law right of control to determine independent contractor status under at least, California's workers' compensation statute. At the same time, the Court declined to adopt any "detailed new standards for examination of the [independent contractor] issue." Borello, supra, 48 Cal. 3d 341 at 353. Rather, the Court seemed to credit heavily three different legal tests.

The decision noted that Restatement guidelines regarding the common law "right of control" test "remain a useful reference" and that the standards set forth in Cal. Lab. Code 2750.5 are also a "helpful means of identifying the employer/contractor distinction." In addition, the Court suggested that six factors adopted by other courts to consider the remedial purpose of the legislation were also helpful to draw lines between the status of employees and independent contractors.

In the final analysis, the Borello Court appears to bring California more closely in line with the IRS's 20 factor analysis (see Attachment B which compares the 20 factor IRS test to the factors set forth in the common law, California Labor Code § 2750.5 (which provides the requirements for licensed construction contractors to be independent contractors) and the factors considered by other courts).

In Borello, the Supreme Court of California held specifically that cucumber pickers were "employees" entitled to workers' compensation coverage based on the following facts: (1) the "sharefarmer" workers at issue had no control over the operation as a whole, e.g., crop cultivation, selection of the buyer and price; (2) sharefarmers had no particular skill or expertise; (3) the work was seasonal, but permanent; (4) sharefarmers had no distinct trade or calling; (5) sharefarmers did not hold themselves out in business; (6) workers invested only their personal service and hand tools; (7) there was no opportunity for profit or loss; the possibility that the crop would fail "is the chance faced by any at-will wage earner that his services will not be needed after all" (Borello, supra, 48 Cal. 3d 341 at 358, n. 11); (8) sharefarmers relied solely on field work for their livelihood; (9) there was no practical opportunity for the sharefarmers and their families to self-insure for workers' compensation coverage; and (10) there was no real opportunity to bargain over the preprinted contract that was offered to heads of families who would harvest the crop.

In a workers' compensation setting, independent contractor status now is found in California "when the provider of service has the primary power over work safety, is best situated to distribute the risk and cost of injury as an expense of his own business, and has independently chosen the burdens and benefits of self-employment." Borello, supra, 48 Cal. 3d 341 at 354.

Of perhaps even greater import from the Borello decision are "implications for the employer-employee relationship upon which other state social legislation depends." Borello, supra, 48 Cal. 3d 341 at 345 (emphasis added). The court noted in dicta that the implications of its decision included application of California laws governing minimum wages, maximum hours and employment of minors (Cal. Lab. Code § 1171, et seq.; Cal. Lab. Code § 1285, et seq.), the antidiscrimination provisions of the Fair Employment and Housing Act (Cal. Gov't. Code §

12940, et seq.) and the Agricultural Labor Relations Act (Cal. Lab. Code § 1141, et seq. The decision did not apply specifically to the California unemployment insurance coverage statute since that statute itself requires that the status of a covered “employee” be determined by the “usual common law rules.” Cal. Unemp. Ins. Code § 621(b); Borello, supra, 48 Cal. 3d at 359, n. 16.

Using a similar “control” analysis, the court of appeals for the First Appellate District held that a taxi driver was an employee of the Yellow Cab Company for the purposes of the California workers’ compensation statute, even though the employer did not completely control the way in which the taxi drivers performed their work. The court noted that Yellow Cab acted as a clearing house for customers and that it promoted a “distinct identity” to attract members of the traveling public, that the driver’s relationship with Yellow Cab could be terminated for misconduct, and that the driver was prohibited from driving for other companies. Yellow Cab Cooperative, Inc. v. Workers’ Compensation Appeals Board and Richard Edwinston, 226 Cal. App. 3d 1288 (1991).

California appellate courts continue to apply Borello, but they have failed to offer a clear indication of whether the common law “right of control” test has been abandoned. Rather, the courts seem content to apply Borello’s multi-factor approach. See, e.g., Ali v. U.S.A. Cab, Ltd., 176 Cal. App.4th 1333, 1347 (2009) [court applied Borello factors in finding that common questions of fact did not predominate and denial of class certification was appropriate; declarations showing cab drivers were not required to use USA Cab’s dispatch service, and that certain drivers supplied their own vehicle items, engaged in independent advertising, and used their own flat rates or rates below the standard metered rate established that individual issues predominated]; Gonzales v Workers’ Comp. Appeals Bd., 46 Cal. App. 4th 1584 (1995) [court applied Borello factors, as well as “right of control” concept, to conclude that newspaper route carrier injured in traffic accident was an employee for purposes of workers compensation, where newspaper specified time of delivery, controlled customers, and received and addressed customer complaints]; Antelope Valley Press v. Poizner, 2008 Cal. App. LEXIS 657 (2008) [court again applied Borello factors as well as “right of control” concept to determine that newspaper carriers were employees for purposes of a workers’ compensation insurance premium since newspaper controlled the manner and means of delivery, remuneration was dependent on non-negotiated financial terms in the contract, many of the carriers had engaged in prolonged service for the publisher, and the carriers were not the parties best situated to distribute the risk and cost of an on-the-job injury]; Braun v. County of San Mateo, 2001 U.S. Dist. LEXIS 13769 (N.D. Cal. 2001) [Emergency medical services medical director was independent contractor under right to control test since principal task of the job was being performed independently, with little or no supervision].

F. Discrimination Tests

Employment is heavily regulated to prohibit various types of discrimination. Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000(e)) and the California Fair Employment and Housing Act (“FEHA”) (Cal. Gov’t. Code § 12940, et seq.), for example, prohibit employers from discriminating against employees on the basis of race, color, religion, sex or national origin. The FEHA and the Age Discrimination in Employment Act (“ADEA”) (29 U.S.C. § 623(a)(1)) prohibit employment discrimination on the basis of age. The FEHA also prohibits discrimination

on the basis of disability and marital status. The California Labor Code prohibits discrimination based on political activity and sexual orientation. Cal. Lab. Code §§ 1101 *et seq.* Federal and state contractors are required to engage in affirmative action to encourage employment of minorities, women, the disabled and Vietnam era veterans.

By their terms, the above-referenced federal laws protect only “employees.” However, in California, at the beginning of this decade, the legislature granted independent contractors the right to bring actions against employers for employment discrimination arising out of their membership in a protected class. Under FEHA, employers are now responsible to protect traditional employees as well as contract workers from employment discrimination. At least one federal circuit court, the First Circuit, has also interpreted 42 U.S.C. § 1981 to include a cause of action for independent contractors for race-based harassment.

To determine whether an individual is an employee, and therefore is protected by discrimination laws, some courts have applied the “economic realities test,” whereas other courts have developed a hybrid test that combines the “control” and the “economic realities” tests. The “right to control” is the most important among several factors, including: method of payment; skill required; furnishing of supplies, tools and workplace; duration of employment; terminability at will; work supervision; and the parties’ intentions.²² In the Third Circuit Court of Appeals, courts reject the common law test and the IRS test to determine whether an individual is an employee as not helpful in any analysis dealing with an anti-discrimination statute.²³ This is because the common law test arose in the context of cases dealing with respondeat superior liability. Rather, the Third Circuit in Zeigler relied on a hybrid “economic realities” test to determine who was an employee for purposes of Title VII. The test is a “hybrid” because the Third Circuit holds that the six-factor list is not exhaustive, and that courts should take into consideration all incidents of the employment relationship.

In 1992, the United States Supreme Court ruled that courts should construe federal statutes using the term “employees” under the common law test if the statute does not meaningfully define the term “employee.” Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 322-323 (1992). Though Darden was an ERISA case, the holding does not rest on that particular statute. Rather, the Court focused on the absence of a definition of “employee” other than “any individual employed by an employer” (29 U.S.C. § 1002(6)). Prior to Darden, a leading court found that substantive interpretation of the ADEA must follow Title VII precedent. E.E.O.C. v. Zippo Mfg. Co., 713 F.2d 32, 38 (3rd Cir. 1983). A subsequent District Court ruling held that Darden overruled Zippo. Cox v. Master Lock Co., 815 F. Supp. 844, 846 (E.D. Pa. 1993), *aff’d*, 14 F.3d 46 (3rd Cir. 1993). Since Darden, courts use the common law test as to whether an individual is an “employee” in the context of federal statutes.²⁴

²² Howard v. City of Kansas City, 2010 Mo. App. LEXIS 134 (February 9, 2010) [factors to be considered in determining whether the requisite level of control exists establish that municipal judges are not employees of the municipality; control over the manner and details of a municipal judge’s work is vested in the state Supreme Court and the 16th Judicial Circuit, limitations on employed is subject to the City’s voters rather than the city, payment is set by ordinance, and adjudication of ordinance violations is a judicial function rather than the city’s duty].

²³ Beuff Enterprises Florida, Inc. v. Villa Pizza, LLC, 2008 U.S. Dist. LEXIS 50591 at p. 28 (D.N.J. 2008) [citing Zeigler v. Anesthesia Assocs. of Lancaster, Ltd., 74 Fed. Appx. 197, 200 (3d Cir. 2003)].

²⁴ For example, the Eighth Circuit Court of Appeals uses the Darden test in application to the term “employee”

Interpretation of the FEHA similarly follows Title VII precedent to the extent both statutes share identical anti-discriminatory objectives and overriding public policy concerns. Los Angeles County Dept. of Parks & Recreation v. Civil Service Commission, 8 Cal. App. 4th 273 (1992), review denied, 1992 Cal. LEXIS 5104 (1992); County of Alameda v. Fair Employment & Housing Com., 153 Cal. App. 3d 499, 504 (1984); see Price v. Civil Service Com., 26 Cal. 3d 257, 271, cert. dis'm sub nom., District Attorney for Sacramento County v. Sacramento County Civil Service Commission, 449 U.S. 811 (1980). In light of Borello, *supra*, it is unclear whether the California FEHA standard will continue to parallel the Title VII hybrid test in the future.

Plaintiffs may argue, even though they are independent contractors, that discrimination led to denial of a privilege that is basic to an employment relationship. For instance, a Palestine-born medical student could sue the hospital in which he was serving his residency for discriminatory failure to extend staff privileges. Amro v. St. Luke's, 39 Fair Empl. Prac. Cas. (BNA) 1574 (E.D.Pa. 1986). Similarly, a Hispanic doctor could sue a hospital for discrimination in not awarding an emergency room care contract to his medical group. Gomez v. Alexian Bros. Hosp. of San Jose, 698 F.2d 1019, 1021 (9th Cir. 1983). Such a broad interpretation of Title VII's language should make employers sensitive to potential discrimination claims from bona fide independent contractors as well as employees.

1. Title VII Case Decisions:

a. Employees: Right to control and economic dependence found.

Demers v. Adams Homes of Northwest Florida, Inc., 2009 U.S. App. LEXIS 5844 (11th Cir. 2009). (The Eleventh Circuit construes the term "employee" in Title VII in light of general common law concepts taking into account the economic realities of the relationship. The determinative factors are common law principles of agency and the right of the employer to control the employee. Sufficient control exhibited based on individual having to staff the office "a minimum of 5 days per week, including Saturday and Sunday;" individual limited to two weeks vacation per year; individual required to provide "ample notice" before taking vacation and the vacation of two weeks could not be taken consecutively; individual could not sell homes other than those of Adams Homes; Adams Homes required attendance at weekly sales meetings; Demers had to call, meet, and invite to lunch realtors a minimum number of times per month; Demers had to submit weekly reports; and Demers received instruction on language to use in sales pitches).

Mitchell v. Frank R. Howard Memorial Hosp., 853 F.2d 762 (9th Cir. 1988), cert. denied, 489 U.S. 1013 (1989) (Mormon radiologist alleging religious discrimination was a hospital employee because he used hospital radiology equipment; he agreed to treat hospital patients; and he was paid by the hospital rather than patients).

Armbruster v. Quinn, 711 F.2d 1332 (6th Cir. 1983) (Case remanded to district court to determine whether "Manufacturer's representative" was employee under economic realities test given Title VII's broad language and the legislative history which favors coverage of all persons

under Title VII, the ADA, and the ADEA. See Wilde v. County of Kandiyohi, 15 F.3d 103, 105 (8th Cir. 1994) [Title VII claim]; Lerohl v. Friends of Minnesota Sinfonia, 322 F.3d 486, 489 (8th Cir. 2003) [ADA claim]; Wortham v. American Family Ins. Group, 385 F.3d 1139, 1140 (8th Cir. 2004) [ADEA claim].

in a position to be harmed by discrimination that Title VII seeks to prevent; district court had ruled below that the manufacturer's representatives were not employees under Title VII because the company did not control the work hours, timing of sales calls, or customers called on, and because the representatives sold product lines from other companies).

- b. Independent contractors: No right to control or economic dependence found.

Adcock v. Chrysler Corp., 166 F.3d 1290 (9th Cir. 1999) (Automobile company's denial of dealership to female applicant did not give rise to gender discrimination claim under Title VII since contemplated contract would have created an independent contractor relationship).

Bender v. Suburban Hosp., 998 F. Supp. 631 (D.Md. 1998) (Physician with privileges at defendant hospital who had complete discretion regarding patient treatment, received no assignments or additional work from the hospital, and was entitled to few hospital benefits, was not the hospital's employee for purposes of Title VII gender discrimination claim, despite fact that hospital provided many of the instrumentalities of physician's work, and provided nursing and clerical staff for her assistance).

Ost v. West Suburban Travelers Limousine, Inc., 88 F.3d 435 (7th Cir. 1996) (Title VII gender discrimination claim by limousine driver against dispatching company properly dismissed, where driver owned her own limousine, paid all fees associated with its ownership, received no paycheck from dispatcher, and could choose to work whenever she wanted, and therefore was not dispatcher's employee, despite fact that dispatcher set the rates drivers could receive from customers, and determined which drivers would receive which customers).

Diggs v. Harris Hospital-Methodist, Inc., 847 F.2d 270 (5th Cir.), cert. denied, 488 U.S. 956 (1988) (Black female obstetrician-gynecologist was not a hospital employee for purposes of Title VII because: (1) there was no evidence that staff privileges were necessary to medical practice; (2) under economic realities/common law test, hospital did not direct the manner or means by which the doctor provided medical care; (3) hospital was not required to admit her patients to the hospital; and (4) the hospital did not pay the doctor for her services).

Broussard v. L. H. Bossier, Inc., 789 F.2d 1158 (5th Cir. 1986) (Woman truck driver, and co-owner of truck with husband, was an independent contractor for purposes of sex discrimination suit. Under an economic realities test of right to control, the female driver co-owned the truck and was responsible for its operating costs; her employment was intermittent; payment was to the couple's trucking company; and options as to the payment method allowed for entrepreneurship to increase profits).

Mares v. Marsh, 777 F.2d 1066 (5th Cir. 1985) (Grocery bagger at an Army commissary was not an employee under hybrid economic realities/common law test where the Army had no role in hiring, firing, supervision or establishing work schedules. Compensation came exclusively from tips and, accordingly, the Army did not report income or withhold taxes. Neither did the Army provide annual medical leave or retirement benefits).

Dixon v. Burman, 593 F. Supp. 6 (N.D.Ind. 1983), aff'd without opinion, 742 F.2d 1459 (7th Cir. 1984) (Independent insurance agent was not an employee where the company did not

control her territory, daily activities or outside employment. Company did not reimburse expenses or provide employee benefits).

Cobb v. Sun Papers, Inc., 673 F.2d 337, reh'g denied, 679 F.2d 253 (11th Cir.), cert. denied, 459 U.S. 874 (1982) (A janitor was an independent contractor based on discretion as to how or by whom the work would be performed; janitor was responsible for hiring helpers. These facts outweighed indicia of employee status: (1) the company gave some detailed instructions to janitor; (2) company provided the basic supplies and equipment; (3) there was no written independent contractor agreement; (4) janitorial firm that replaced the plaintiff had a written independent contractor agreement; and (5) the janitor did not report payments as business income on his tax returns).

Lutcher v. Musicians Union Local 47, 633 F.2d 880 (9th Cir. 1980) (A musician whose Seventh Day Adventist beliefs prohibited payment of union membership dues was undisputedly an independent contractor for purposes of a religious discrimination suit against union. The musician employed, transported and equipped members of the group, paid his own insurance and received compensation upon completion of each performance. The Ninth Circuit applied an economic realities/"right to control" test).

2. Age Discrimination in Employment Act (ADEA) Case Decisions:

a. Right to control found.

Simpson v. Ernst & Young, 100 F.3d 436 (6th Cir. 1996) (partner in Arthur Young terminated shortly after merger of with Ernst & Whinney held to be an employee because of partnership agreement which centralized all firm management power in a small committee of partners, and which gave the plaintiff no right to participate in firm management, to examine the firm's books and records, or to have any involvement in personnel decisions).

b. No right to control or economic realities found.

Williams v. CF Med., Inc., 2009 U.S. Dist. LEXIS 19015 (N.D.N.Y. 2009). (The fact that the sales representative worked out of his home, was paid a straight commission for his services, did not receive insurance benefits and did not participate in the company's retirement plan, received Form 1099s instead of W2s for each year of his relationship with the company, and filed his taxes as a self-employed person indicated that he was an independent contractor not subject to the ADEA).

Barnhart v. New York Life Insurance Co., 141 F.3d 1310 (9th Cir. 1998) (insurance agent who sued his employer under the ADEA after his termination for failure to maintain minimum production standards held to be an independent contractor and not covered by the ADEA, because of contract which clearly identified him as independent contractor, and tax returns wherein plaintiff stated he obtained most of his income from self-employment).

E.E.O.C. v. North Knox School Corp., 154 F.3d 744 (7th Cir.1998) (ADEA claims brought by bus drivers who contracted with school district were dismissed on summary judgment, where drivers were required to supply their own buses and absorb all associated costs, including insurance and maintenance, and despite fact that school district, as dictated by statute,

could control the use to which the buses could be put when the drivers were not transporting school children).

E.E.O.C. v. Zippo Mfg. Co., 713 F.2d 32 (3rd Cir. 1983) (Salespersons were independent contractors where they established their own business organizations, hired their own employees, made their own customer contacts and were not required to account to the company for their daily activities. Duration of employment, more than 10 years in some instances, was not sufficient alone to establish employee status).

Garrett v. Phillips Mills, Inc., 721 F.2d 979 (4th Cir. 1983) (Finding that salesman was independent contractor was based on minimal supervision by company. Salesman also paid his own expenses, paid self-employment taxes and established a Keogh retirement plan).

Hickey v. Arkla Industries, Inc., 699 F.2d 748 (5th Cir. 1983) (Sales representative was independent contractor because he was not required to deal exclusively with company, he could establish his own business organization and terminate relationship with company on 30 days' notice. Sales representative also paid his own business expenses).

3. The Americans With Disabilities Act

In Clackamas Gastroenterology Associates, P & NBSP, 538 U.S. 440, (2003), the United States Supreme Court adopted the federal common law definition for the term "employee" as used in the Americans with Disabilities Act (ADA). The question presented was whether four physicians actively engaged in medical practice as shareholders and directors of a professional corporation should be counted as "employees" within the meaning of the ADA.

Noting that it had "...often been asked to construe the meaning of 'employee' where the statute containing the term does not helpfully define it" (citation omitted), the Court noted that the ADA "simply states" that an "employee is an individual employed by an employer". Accordingly, the court initially concluded that the ADA statutory definition was "completely circular and explains nothing". Citing its earlier decision in Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 322 (1992) [defining the term "employee" within the meaning of ERISA] and Community of Creative Non-Violence v. Reid, 490 U.S. 730 (1989), the court explained that "when Congress has used the term 'employee' without defining it, we have concluded that Congress intended to describe the conventional master-servant relationship as understood by common-law agency doctrine".

Accordingly, the court remanded the case to the trial court to search the trial record for facts which would allow the trial court to conclude whether the at-issue physician-shareholders were "employees" (covered by the ADA) or "partners" (not so covered).

G. The National Labor Relations Act (NRLA)

The National Labor Relations Act excludes from its coverage independent contractors. 29 U.S.C. § 152(3). The National Labor Relations Board ("NLRB") and the courts generally apply the "right of control" test to determine whether a worker is an employee entitled to protection under the Act. See N.L.R.B. v. United Insurance Co., 390 U.S. 254, 256 (1968). If the employer retains the right to control the way the task is performed, the Board is likely to find

an employment relationship. If control is only reserved as to the end result, a finding of independent status is substantially more likely. All of the facts and circumstances are balanced to determine the extent to which the employer exerted control over performance. This standard applies in all NLRA contexts, such as protection of concerted activity and the right to vote in representation elections.

The California Agricultural Labor Relations Act (“ALRA”) (Cal. Lab. Code § 1141, et seq.), by its terms, covers agricultural workers excluded from coverage under the NLRA. These workers are among those who appear to be subject to Borello’s rejection of the common law right-to-control test for determining independent contractor status.

1. Employees: Right to control found.

Time Auto Transportation, Inc., 2002 NLRB LEXIS 628, 338 NLRB No. 75 (2002) (drivers who haul vehicles using tractor-trailers they lease from company are statutory employees of company since company sought to exercise control over the manner of driver’s work performance by encouraging drivers to exceed Department of Transportation drive-time limits and falsifying logs).

First Legal Support Services, 2002 NLRB LEXIS 231 (2001) (Bike messengers working for business that provided courier services and court records research for law firms were employees).

Roadway Package System, Inc., 326 N.L.R.B. No. 72, 159 L.R.R.M. (BNA) 1153 (1998) (Pickup/delivery drivers who: (1) receive training from the company, (2) perform pickups and deliveries in the company’s name, (3) are prohibited from conducting outside business for other companies throughout the day, and (4) although they own their own trucks, essentially are unable to use the trucks for other purposes during off-hours, are employees of the company, not independent contractors, under the right of control test).

Siracusa Moving & Storage Service Co., 291 N.L.R.B. 143, 130 L.R.R.M. (BNA) 1062 (1988) (Truck driver on commission, who attempted to organize a union, was an employee, rather than an independent contractor, where the company owned the truck and paid for insurance and repair even though the truck driver paid for fuel, tolls and any additional labor).

Roadway Package System, Inc., 288 N.L.R.B. 196, 128 L.R.R.M. (BNA) 1016 (1988) (Pick-up and delivery drivers are employees under common law test where: (1) owner has substantial control over manner and means of operating business; (2) the owner supervises, disciplines and fires drivers; and (3) drivers bear few risks and enjoy little opportunity for gain. Drivers receive no commissions for sales leads and have no proprietary interest in the geographical zones they service).

Merry Oldsmobile, Inc., 287 N.L.R.B. 847, 127 L.R.R.M. (BNA) 1175 (1987) (A salesperson selling financing, different types of insurance, alarm systems and extended warranty programs, after purchase of car, is an employee under the “right of control” test. The “after sale” worker’s hours are controlled by the company’s hours of operation; the work is done at the car dealership; earnings ultimately are dependent on referrals from salespeople; and sales of items are from the dealer’s inventory).

N.L.R.B. v. H & H Pretzel Co., 831 F.2d 650 (6th Cir. 1987) (Employer failed to transform unionized pretzel company drivers into independent contractors by setting up separate company for leased drivers, which, incidentally, was owned by same person who owned pretzel company. Drivers were employees since distributor controlled the work and could discharge the drivers, and the drivers had no proprietary interest in the business).

ARA Leisure Services, Inc. v. N.L.R.B., 782 F.2d 456 (4th Cir. 1986) (Sports arena concessionaire unlawfully discharged employees, rather than independent contractors, two weeks before scheduled union election. Application of the “right to control” test found that the novelty vendor “tableheads” exhibited indicia of employee status: (1) the concessionaire made payroll deductions for state and federal withholding taxes, workers’ compensation and Social Security; (2) vendors check in and out of work, follow an employee handbook and are subject to progressive discipline; and (3) the work is largely unskilled and of indefinite duration. Although the vendors could exercise some entrepreneurial skill in hawking their wares, the products and prices were predetermined. All necessary equipment was provided to the vendors without any capital outlay).

a. Independent contractors: No right to control found.

FedEx Home Delivery v. NLRB, 2009 U.S. App. LEXIS 8272 (D.C. Cir. 2009). (National Labor Relations Board found that employer failed to bargain with valid collective bargaining representative. However, upon appeal of the Board’s determination, the court found that drivers were actually independent contractors that could not unionize since the ability to operate multiple routes, hire additional drivers and helpers, and to sell routes without permission, as well as the parties’ intent expressed in their contract, argued strongly in favor of independent contractor status. Because the evidence supporting independent contractor status was more compelling under the court’s precedent, the Board’s determination was legally erroneous).

Dial-A-Mattress Operating Corp., 326 N.L.R.B. No. 75, 159 L.R.R.M. (BNA) 1166 (1998) (drivers for mattress company who: (1) arrange their own training, (2) hire and have sole responsibility for their own employees; (3) own and maintain their own trucks, (4) maintain their own workers compensation insurance; and (5) are held out by the company as “independently owned and operated” drivers, were independent contractors under the right of control test).

North American Van Lines, Inc. v. N.L.R.B., 869 F.2d 596 (D.C.Cir. 1989) (The Board overstepped its jurisdictional bounds in finding truck drivers employees; they were independent contractors since they (1) exercised nearly absolute control over work performance, work clothing, route to be followed and decisions where and when to work, stop, eat and rest; (2) held equity interests in their trucks and a significant minority owned one or more trucks outright; (3) assumed significant entrepreneurial risks regarding frequency of work, maintenance and repair; and (4) admitted employees received a fringe, supplemental and profit-sharing benefits not available to the drivers. The circuit court cautioned the Board that: (1) oversight of worker performance does not necessarily equate with the right to control; (2) government regulations that structure work performance do not constitute employer control; and (3) unequal bargaining power, without more, is not evidence indicative of employer control.). Note that the Board, in Container Transit, Inc., 281 N.L.R.B. 1039, 124 L.R.R.M. (BNA) 1349 (1986), agreed that government regulations were insufficient in and of themselves to show employment status.

City Cab Company of Orlando, Inc., 285 N.L.R.B. 1191, 129 L.R.R.M. (BNA) 1246 (1987) (Taxi cab drivers are independent contractors because: (1) cab owner does not control or supervise drivers' work performance; (2) lease fees paid by drivers represent substantial investment; (3) safety requirements and other rules do not constitute owner control over cab operations; (4) cab owner does not deduct for state, federal or Social Security taxes; (5) lease drivers do not receive health benefits, workers' compensation or unemployment compensation; and (6) finding that cab drivers are independent contractors agrees with findings by other governmental agencies, including Internal Revenue Service and Equal Employment Opportunity Commission).

La Salle Investment Co., Ltd., 280 N.L.R.B. 379, 122 L.R.R.M. (BNA) 1281 (1986) (A janitor at a commercial building was an independent contractor since he decided how to do work; cleaning could be done at any time outside normal business hours; work was paid at flat rate; and janitor could subcontract work).

H. California EDD's Special Provisions For Workers In The Computer Services Industry

California's Employment Development Department ("EDD") has enacted specific regulations to define when workers in the computer services industry are independent contractors instead of employees. See Title 22 Cal. Code Regs. Div. 1, Subd. 1, Div. 2.5, Chpt. 1, § 4304-4. Although these rules technically apply only to EDD audits of contractor status for purposes of determining whether the employer must make wage-related withholdings, deductions, and contributions as to payments made to contractors, the rules would appear to provide persuasive guidance on how contractor status of computer workers should be evaluated under other laws as well.

These regulations apply to any "computer consultant," which is defined as "an individual who performs various computer-related services, including, but not limited to:

- (1) Development and design of hardware, software or firmware;
- (2) Technical leadership and advice in computer-related services;
- (3) Programming for computer applications;
- (4) Developing and writing system procedures;
- (5) System design;
- (6) Maintenance of software;
- (7) Training of staff in computerized systems and other computer applications;
- (8) Computer-related technical writing.

Although these regulations confirm that EDD uses the same general legal tests (e.g., right to control) to evaluate the contractor status of computer workers, the regulations indicate that EDD will be more lenient when applying certain factors to computer workers. The paragraphs below outline the most notable nuances in how the EDD applies the traditional tests for contractor status to computer workers:

1) Control

While EDD would normally consider a worker's practice of keeping normal working hours a factor in favor of employee status, this is not necessarily evidence of employee status as to computer workers. If the contractor maintains normal working hours solely because of the need to maintain contact with the company, keeping regular hours will not be considered as an indication of employee status.

2) Premises and Facilities

Similarly, EDD normally considers performing work on-site a factor indicating employee status. However, EDD regulations recognize that when a computer consultant performs services on large computer systems, it is generally impossible for the work to be performed off-site. Thus, in the computer services industry, performing services on the principal's premises is usually not evidence of an employment relationship, especially if it is being performed on-site because of practical necessity or security concerns. On the other hand, if the services could be performed with equal ease off-site, performing work on-site may be considered a factor indicating employee status.

3) Continuing Relationship

While EDD normally considers a long-term continuing relationship to be a factor indicating employee status, there is a possible exception for computer workers. For work on one isolated project, the end result of which may not be achieved for an extended period of time, the length of the project is not necessarily evidence of employee status. This is especially true if the computer worker also performs work for other clients/principals during the course of a lengthy project.

4) Payment

EDD normally considers hourly payment to indicate that a worker is an employee. However, there is an exception for computer workers because they are often paid on an hourly basis due to the nature of work in the industry. As a result, EDD regulations state that payment computed on an hourly basis is not necessarily evidence of employee status. Where the principal and the computer worker negotiate the hourly rate, this may be evidence that the worker is an independent contractor; but if the principal sets the hourly rate, this may be evidence of employee status.

5) Training

When a principal provides training to a worker, such training is normally evidence of employee status. However, for computer workers, unique training for a specific project is not

considered evidence of employee status, especially if this is stated as part of the initial agreement.

6) Service in the Principal's Regular Business

Normally, work performed in the course of the principal's regular business is evidence of employee status. This is not necessarily true for computer workers. If a computer services worker installs, creates, repairs, or modifies hardware or software for a discreet project, EDD regulations state that this does not necessarily indicate that the worker is an employee. This is especially true where the work is performed over a short period of time.

7) Walkthroughs and Conferences

Although the right of control is a key factor in determining if a worker is an employee or an independent contractor, there is an exception for "walkthroughs" in the computer services industry. A "walkthrough" is a conference held from time to time with the principal or other team members to critique a product's performance and identify technical errors. Because this type of conference is common in the computer services industry, such a conference is not necessarily evidence of the principal's right of control, and is therefore not necessarily evidence of employee status.

I. The Immigration Reform and Control Act ("IRCA")

The Immigration and Naturalization Service (now the U.S. Citizenship and Immigration Services ("USCIS")), a bureau of the Department of Homeland Security) has stated it will use the IRS's 20-factor test to make employee/independent contractor determinations under this statute which regulates the employment of aliens. 52 Fed. Reg. 16219 (1987). Under IRCA, all employers with three or more employees are required to verify that their employees hired after November 6, 1986 are legally entitled to be employed in the United States. Employer penalties for hiring illegal aliens and for failing to maintain records of verification will not apply if the worker truly is an independent contractor. The USCIS will examine closely the work relationship to determine that independent contractor status is not a sham. If the employer has classified workers incorrectly, substantial civil and criminal penalties can result.

J. Worker Adjustment and Retraining Notification Act ("WARN")

The federal Worker Adjustment and Retraining Notification Act (29 U.S.C. § 2101, et seq.) went into effect February 4, 1989. Under this law:

1. Covered "employers" must give 60 days' written notice of "plant closures" or "mass layoffs;"
2. Such notice must be given to each "affected employee" (or the collective bargaining representative(s), if applicable), to the local government and to the state "dislocated worker unit;" and
3. Remedies include lost wages and benefits to affected employees; \$500 per day fine, up to 60 days, to local government unless the employer pays the full amount of "notice

pay” to the employee within three weeks of the plant closing or mass layoff; and attorneys’ fees. There is no provision for injunctive relief.

WARN governs all businesses employing (a) 100 or more full-time employees, excluding part-time workers, or (b) 100 or more full- or part-time workers who in the aggregate work at least 4,000 hours per week (exclusive of overtime). A “part-time worker” is defined as one who works 20 hours per week or less, or has been employed fewer than six of the 12 months preceding the date on which notice is required.²⁵ Workers on temporary layoff are counted as employees for the purpose of determining coverage of WARN. Bona fide independent contractors are not employees under WARN.

The U.S. Department of Labor’s Final WARN regulations issued April 20, 1989 exclude independent contractors from the definition of “affected employees” covered by the WARN statute. See 20 C.F.R. § 639.3(e). Moreover, the preamble to the final WARN regulations indicates that the Department did not intend to specially define the term “independent contractor” in the regulations. Rather, the final WARN regulations at 20 C.F.R. § 639.3 are intended to

“... summarize existing law developed under such statutes as the NLRA, the Fair Labor Standards Act [FLSA] and the Employee Retirement Income Security Act [ERISA]. The Department does not believe that there is any reason to attempt to create new law in this area especially for WARN purposes when relevant concepts of State and federal law adequately cover the issue.”

54 Fed. Reg. 16042, 16045 (1989).

Accordingly, employers will face the not insubstantial task of trying to demonstrate that workers they believe to be independent contractors are not employees within the meaning of the several different legal tests for independent contractors set out in the three labor statutes referenced in the regulatory preamble. However, once it is established that a worker is an independent contractor, the employer will have the comfort of knowing that that worker is not covered by the Act.

K. California Unemployment Insurance

The California Supreme Court’s Borello decision implies that California courts will continue to use the common law “control” test to determine “employee” eligibility for California Unemployment Insurance, noting the Unemployment Insurance Code itself requires application of the usual common law rules.²⁶ Cal. Unemp. Ins. Code § 621(b); Borello, *supra*, 48 Cal. 3d 341 at 359, n. 16. At least one court subsequent to Borello, which construed § 621, affirmed the use of the right of control test. Santa Cruz Transp. Co. v. Unempl. Ins. Appeals Bd., 235 Cal. App. 3d 1363 (1991) (“The right to control the means by which the work is accomplished is clearly the most significant test of the employment relationship”). The Borello decision also

²⁵ Although part time employees are not counted for coverage purposes, once WARN is triggered, all full time and part time employees must receive notice of a plant closing or mass layoff that affects them. However, “temporary” employees are excluded from this requirement.

²⁶ Except corporate officers, who are classified as employees per that code. Cal. Unemp. Ins. Code § 621.

noted that a prior precedential decision of the Unemployment Insurance Appeals Board found that cucumber pickers were independent contractors. Borello, supra, 48 Cal. 3d 341 at 359, n. 16. California Unemployment Insurance Code § 656 also provides a rebuttable presumption that engineers, architects, accountants and various types of physical and chemical scientists are independent contractors because of their specialized knowledge and skill.

1. Employees: Right to Control Found

Associated Indian Services, Inc. v. Employment Development Department, Precedent Tax Decision No. P-T-450 (1986) (Doctors, dentists, hygienists, nurses, optometrists, nutritionists and paramedics providing health care at clinic were employees despite contracts declaring health care professionals to be independent contractors. The presumption of Unemployment Insurance Code § 656 that professionals (including engineers, architects and accountants) are independent contractors was rebutted because health care providers did not act as consultants. Applying the common law test and emphasizing right of control, the decision found employees subject to the clinic's control, a probationary period, set hours and a defined place of work. The clinic provided most supplies and equipment, and the clinic failed to show that physicians had private practices).

2. Independent contractors: No Right to Control Found

Armstrong v. Department of Employment, Precedent Tax Decision No. P-T-404 (1979) ("Right of control" is most important of common law factors; accountant was independent contractor even though working for accounting practices which employees possessed similar skills; only a small part of working time was devoted to accounting firm and worker determined time and manner of performance; engagement at inexpensive hourly rate and furnishing of instrumentalities not sufficient to find employment relationship).

Charted Services of California, Precedent Tax Decision No. P-T-406 (1979) (Individual operating in multiple roles for corporation--owner, officer, director and salesman--may be employee for some roles and independent contractor for other roles. Insurance sales commission payments legitimately were made to salesman as independent contractor).

L. California Workers' Compensation Laws

California employers must carry workers' compensation insurance for all employees or provide self-insurance. Once insurance is obtained, the workers' compensation statute provides the sole remedy for job-related illness or injury suffered by the employee. A covered employee cannot sue the employer for tort damages in court, but the employee need not prove employer fault or negligence to recover benefits. Independent contractors, conversely, are not entitled to recover workers' compensation benefits, but they may sue the employer in tort for harm caused by the employer. As the Supreme Court of California noted in S.G. Borello & Sons v. Department of Industrial Relations, supra, 48 Cal. 3d 341, the determination of who is an employee for purposes of workers' compensation coverage is no longer governed by the common law right-to-control test in California. However, as described above in Gonzales, supra, the details of its replacement are no more clear now than they were in 1989.

An employer also has the option to make an independent contractor a “special employee” solely for the purpose of workers’ compensation. The employer can accomplish this by naming the individual a special employee in the agreement “for the purpose of workers’ compensation coverage only.” This step may provide the employer with some protection from exposure to tort suits. However, the employer runs the risk that a classification of “employment” status for workers’ compensation purposes will be used as evidence of employment in regard to other statutes.

If an employer chooses to maintain a complete independent contractor relationship, and the independent contractor has his own employees, employers frequently require the contractor to obtain his own workers’ compensation coverage for those employees. In Rinaldi v. Workers’ Compensation Appeals Board, 196 Cal. App. 3d 571 (1987), a licensed general contractor was found liable to pay workers’ compensation to the employee of an unlicensed and uninsured subcontractor burned while hot-tarring a roof for his employer. The ultimate service provider (the general contractor) was liable for injuries to the unlicensed contractor and that contractor’s employees.

The Rinaldi holding comports with Cal. Lab. Code § 2750.5 which provides that an unlicensed construction subcontractor cannot maintain independent contractor status.²⁷ In practice, this rule protects general contractors against tort claims brought by injured employees of unlicensed subcontractors. In Lewis Lee Neighbours v. Buzz Oates Enterprises, 217 Cal. App. 3d 325 (3rd Dist. 1990), for example, the court dismissed the personal injury (tort) claim of an unlicensed subcontractor’s employee against a general contractor because workers’ compensation constituted the employee’s exclusive remedy against the general contractor. The general contractor thus acted as the employee’s de facto employer for workers’ compensation purposes, even though the subcontractor maintained workers’ compensation insurance for its employees.

M. Workers’ Compensation vs. The “Peculiar Risk” Doctrine

The “peculiar risk” doctrine is an exception to the general rule that a person who hires an independent contractor is not liable to third parties for injury caused by the contractor’s negligence in performing the work.²⁸ The peculiar risk exception pertains to contracted work that poses some inherent risk of injury to others. California courts have historically reasoned that a property owner who undertakes inherently dangerous work on his property should not escape liability for injuries to others simply by hiring an independent worker to perform the work. The courts therefore adopted the peculiar risk doctrine to ensure that innocent third parties injured by the negligence of an independent contractor hired by a property owner to do inherently dangerous work on the property would not have to depend on the independent contractor’s solvency to receive compensation for the injuries. See Aceves v. Regal Pale Brewing Co., 24 Cal. 3d 502, 508 (1979); Woolen v. Aerojet General Corp., 57 Cal. 2d 407, 410-411 (1962).

²⁷ The court in Travelers Ins. Co. v. Workers’ Comp. Appeals Bd., 147 Cal. App. 3d 1033, 1037 (1983) has held that as a matter of law, independent contractor status cannot be found unless the person holds a valid contractor’s license. Conversely, a similar rebuttable presumption under Cal. Lab. Code § 2750.6 states that a licensed physician providing services to a primary care clinic is an independent contractor.

²⁸ This doctrine also goes by the names “specific risk” and “inherent risk.”

In a landmark 1993 decision, Privette v. Superior Court, 5 Cal. 4th 689 (1993), however, the Supreme Court of California partially overruled Aceves and Woolen, and altered the application of the peculiar risk doctrine as it relates to employees of independent contractors. The case began when Franklin Privette hired Jim Krause Roofing, Inc., to install a tar and gravel roof on his duplex used as rental property. A Krause foreman instructed Jesus Contreras, a Krause employee, to carry a bucket of molten tar up an unstable ladder. Contreras was burned severely by the tar when he fell from the ladder.

Contreras recovered workers compensation from Krause but also sued Privette on a peculiar risk theory (under which an independent contractor's employees seek to recover from a non-negligent property owner for injuries the negligent independent contractor caused). A minority of jurisdictions, including California, had recognized and permitted recovery under the "peculiar risk" doctrine. Landlord Privette argued that the peculiar risk doctrine should not be applicable to injuries employees of independent contractors suffered because employees are covered by workers compensation.

The trial court denied Privette's motion for summary judgment. The court of appeal summarily denied Privette's petition for a writ of mandate. The California Supreme Court granted review, however, and reversed. The court held that when injuries from an independent contractor's performance of inherently dangerous work are to an employee of the contractor, and thus subject to workers' compensation coverage, the doctrine of peculiar risk affords no basis for the employee to seek recovery in tort damages from the person who hired the contractor but did not cause the injuries.

The court explained that the peculiar risk doctrine should not be applied to claims by an injured contractor's employee because the policy underpinnings for the doctrine are already served by the workers' compensation laws: (1) to ensure that the cost of industrial injuries are part of the cost of goods rather than a burden on society; (2) to guarantee prompt, limited compensation for an employee's work injuries, regardless of fault, as a cost of production; (3) to encourage industrial safety; and (4) to insulate the employer from tort liability for his employee's injuries.²⁹

The court also noted that, under California's historically expansive view of the doctrine, an anomalous result is produced because a non-negligent third party's liability for an injury is greater than that of the negligent employer's. Adding to the inequity is the contractor's immunity from equitable indemnification of the innocent hiring party when workers' compensation covers the employee's injury, the court said. This situation had been subject to considerable criticism, because the availability of equitable indemnity and compensation to the injured worker were among the main policy reasons behind the development of the peculiar risk doctrine, the court observed.

Considering the peculiar risk doctrine in light of the goals the workers' compensation statutes seek to achieve, the court concluded that extending the doctrine to the employees of an independent contractor was unwarranted. In light of its decision, the court did not address

²⁹ Padilla v. Pomona College, 166 Cal. App.4th 661, 669 (2008).

Privette's contentions that the transport of hot tar up a shaky ladder was a "collateral," as opposed to a "peculiar," risk of tar and gravel roofing.

In 1998, the California Supreme Court clarified the broad scope of its opinion in Privette, *supra*. In Toland v. Sunland Housing Group, Inc., 18 Cal. 4th 253 (1998), the plaintiff argued that Privette eliminated peculiar risk liability under section 416 of the Restatement (Second) of Torts, but not under section 413. The court rejected this interpretation, holding that Privette bars employees of a hired contractor injured by the contractor's negligence from seeking recovery against the hiring person, "irrespective of whether recovery is sought under the theory of peculiar risk set forth in section 416 or 413 of the Restatement Second of Torts."³⁰

As noted above, the California Supreme Court in Hooker followed its prior holdings in Privette and Toland. In Hooker, the court held that an entity which retains the services of an independent contractor is not liable to the contractor's employee merely because the entity retaining the service retained control at the worksite. Rather, the entity which retained the services, would be liable if its exercise of the retained control affirmatively contributed to the employee's injury. Citing both Privette and Toland, the Court expressed reluctance to subject the entity retaining the services to greater liability than the contractor who actually caused the injury but whose liability would be limited under worker's compensation laws.

The peculiar risk doctrine has been addressed (and largely rejected) by most other jurisdictions. Two federal appellate opinions, Monk v. Virgin Islands Water & Power Auth., 53 F.3d 1381 (3rd Cir. 1995), *cert. denied*, 516 U.S. 914 (1995), and Chaffin v. United States, 176 F.3d 1208 (9th Cir. 1999), provide a good summary of the treatment of this doctrine by other state and federal courts.

III. JOINT EMPLOYER DOCTRINE

The "joint employer" doctrine is frequently raised when the government seeks to enforce statutes, such as the Fair Labor Standards Act, against both a temporary help agency and its client.³¹ The Wage-Hour Division of the U.S. Department of Labor has issued regulations

³⁰ Toland, 18 Cal. 4th at 267. The Restatement (Second) of Torts § 413 provides:

One who employs an independent contractor to do work which the employer should recognize as likely to create, during its progress, a peculiar unreasonable risk of physical harm to others unless special precautions are taken, is subject to liability for physical harm caused to them by the absence of such precautions if the employer (a) fails to provide in the contract that the contractor shall take such precautions, or (b) fails to exercise reasonable care to provide in some other manner for the taking of such precautions.

Restatement (Second) of Torts § 416 provides:

One who employs an independent contractor to do work which the employer should recognize as likely to create during its progress a peculiar risk of physical harm to others unless special precautions are taken, is subject to liability for physical harm caused to them by the failure of the contractor to exercise reasonable care to take such precautions, even though the employer has provided for such precautions in the contract or otherwise.

³¹ Bamgbose v. Delta-T Group, Inc., 2010 U.S. Dist. LEXIS 10681 (E.D. Penn. February 8, 2010) [individual questions of fact predominate in joint employer context since Delta-T, as a temporary staffing agency for healthcare workers, provided different levels of supervision and different requirements for retention depending upon client's needs and requirements; court would have to undertake an examination of the workers' distinct relationships with Delta-T and its various clients].

discussing joint employment. 29 C.F.R. § 791.2. These regulations provide that a joint employment relationship may be found where employers share an employee's services, where one employer is acting in the interest of another employer or where the employers are not completely disassociated with respect to the employment of the individual and may be deemed to share control of the employee.

Regulations issued by the U.S. Department of Labor in the farm labor context provide additional guidance to determine joint employer status. 29 C.F.R. § 500.20. The courts have applied these regulations in non-agricultural contexts. Economic reality has been the key to determining whether a joint employment relationship exists in the wage and hour context.

The U.S. Department of Labor has long recognized the joint employer concept where temporary worker agencies are involved. The Wage-Hour Division has issued opinion letters concluding that "employees of a temporary help agency working on assignment in various business establishments are joint employees of both the agency and the business establishment in which they are employed." Wage-Hour Administrative Ruling, No. 781 [Transfer Binder] Lab.L.Rep. (CCH) 30,778 (1968); See also, Wage-Hour Administrative Ruling, No. 960 [Transfer Binder] Lab.L.Rep. (CCH) 30,975 (1969).

Courts have considered the following factors: (1) the power to hire, fire and supervise; (2) control of the worker's work schedule and other conditions of employment; (3) determination of the rate and method of payment; and (4) maintenance of employment records. Bonnette v. California Health and Welfare Agency, 704 F.2d 1465 (9th Cir. 1983). In Bonnette, individuals who performed chores for disabled welfare recipients were found to be jointly employed by state agencies and the welfare recipients to whom the workers were assigned by the state. The agencies provided the funds to pay the workers, but the welfare recipients supervised the workers on a day-to-day basis.

Other factors include where the work is done, how much control the employer exerts, whether the company has the power to hire, fire or modify the terms and conditions of employment, whether the employees perform "specialty jobs" within the employer's organization and whether the employees can work for others. Hodgson v. Griffin and Brand of McAllen, Inc., 471 F.2d 235 (5th Cir. 1973), cert. denied, 414 U.S. 819 (1973). In Hodgson, joint employment was found where independent "crew leaders" recruited farm workers and provided some supervision, but the farm owner set the rate of pay, made Social Security payments and was ultimately responsible for the workers, supervision. Joint employer status was similarly found in Real v. Driscoll Strawberry Associates, Inc., 603 F.2d 748 (9th Cir. 1979) where strawberry growers worked under a patent sublicense agreement with a farm owner and were paid by the owner, but hiring, firing and control were shared by the farm owner and the owner of strawberry patent.

If joint employment status is established, "employers" can be held jointly and severally liable for compliance with wage and hour laws (29 C.F.R. § 791.2). Joint employment status also can have an impact in the other areas discussed in this outline, such as liability for work-incurred injuries, discriminatory acts and company benefits.

Joint employer issues often arise in the context of “leased employees,” one of the many classes of workers which fall within the penumbra of independent contractors. With staffing firms, the relationship between the firm and its workers typically qualifies as an employer-employee relationship, because of the firm’s control over hiring, firing, and payment of the worker. See EEOC Policy Guidance on Contingent Workers (Dec. 3, 1997). However, the staffing firm might not qualify as the employer where a separate company places its own employees on a staffing firm’s payroll, so as to transfer the time-consuming tasks of administering wages and benefits. *Id.* In that scenario, the staffing firm leases back the workers to the company, and the workers do not have an employer-employee relationship with the staffing firm. See, e.g., Astrowsky v. First Portland Mortgage Corp., 887 F. Supp. 332 (D. Me. 1995) (in action for wrongful discharge and Title VII violations, employee leasing firm not a joint employer of worker whom it leased back to original employer, where firm merely processed payroll, but exercised no control over the worker).

IV. WRONGFUL DISCHARGE LIABILITY

The California Supreme Court in Seaman’s Direct Buying Service, Inc. v. Standard Oil Co., 36 Cal. 3d 752 (1984), discussed the potential application of the implied covenant of good faith and fair dealing to contexts outside of just insurance relationships. The court, in commentary not necessary to the decision, noted that injecting the tort remedy into purely “commercial contexts” would involve entering “uncharted and potentially dangerous waters This is not to say that tort remedies have no place in such a commercial context, but that it is wise to proceed with caution in determining their scope and application.” *Id.* at 769. Since the independent contractor relationship lies somewhere between the employment relationship and a “purely commercial” arrangement, the potential for application of the tort remedy seems considerable. Note that the *Foley* decision has limited the remedy for breach of the covenant of good faith and fair dealing to contract damages. Foley v. Interactive Data Corp., 47 Cal. 3d 654 (1988).

An appellate decision in California in which the court found the distinction between employees and independent contractors “trivial” has been depublished and therefore is not valid precedent. The decision had assumed that wrongful termination tort remedies were available to an independent contractor. Caplan v. St. Joseph’s Hospital, 188 Cal. App. 3d 1193 (1987) (depublished).

The valid precedential position, at least in California, is that independent contractors cannot sue in tort for wrongful discharge. In Abrahamson v. NME Hospitals, Inc., 195 Cal. App. 3d 1325 (1987), a doctor had contracted with the hospital to manage the laboratory and pathology department for one year. Each party had the right to terminate without cause upon 90 day’s notice. The doctor sued under a variety of public policy and good faith covenant theories after his services were terminated with notice. The doctor claimed he was terminated because he would not condone the poor patient care in the hospital.

California is not alone in barring independent contractors from maintaining wrongful discharge claims. See Ostrander v. Farm Bureau Mut. Ins. Co., 851 P.2d 946 (Idaho 1993) (plaintiff’s status as independent contractor prevented her from bringing wrongful discharge claims); New Horizons Elecs. Mktg., Inc. v. Clarion Corp. of Am., 561 N.E.2d 283 (Ill. App. Ct.

1990); Harper v. Healthsource N.H., Inc., 674 A.2d 962 (N.H. 1996) (HMO physician precluded from bringing wrongful discharge claim); MacDougall v. Weichert, 677 A.2d 162 (N.J. Sup. Ct. 1996) (wrongful discharge doctrine does not protect independent contractors); Cogan v. Harford Memorial Hosp., 843 F. Supp. 1013, 1022 (D. Md. 1994) (Maryland has not addressed extension of the right to sue for wrongful discharge to independent contractors).

In Wallis v. Farmers Group, Inc., 220 Cal. App. 3d 718 (1990), review denied, 1990 Cal. LEXIS 3716 (1990), the court upheld a jury verdict awarding contract damages to an insurance agent whose agency was terminated without good cause. However, the court reversed the verdict to the extent it awarded the agent--an "independent contractor" in the court's terms--tort damages for breach of the implied covenant of good faith and fair dealing, ruling that under Foley such damages were unavailable. Id. at 734-736.

V. EMPLOYMENT LAWS THAT APPLY (OR MAY APPLY) TO INDEPENDENT CONTRACTORS

As noted above, the law pertaining to independent contractors is always evolving. A trend has been emerging, both on the federal and state level, whereby independent contractors are being granted more and more rights traditionally afforded only to employees. This section examines how employment laws which in the past only applied to employees, are now being used (or may be used) to protect independent contractors.

A. Prohibited Forms of Discrimination

Although independent contractors have no rights under most employment discrimination laws,³² Title 42 United States Code Section 1981 provides a cause of action to independent contractors for discrimination in contracting on the basis of race, color, or ancestry. Danco, Inc. v. Wal-Mart Stores, Inc., 178 F.3d 8, 13-14 (1st Cir. 1999), modified, 79 FEP 1737 (1st Cir. 1999), cert. denied, 528 U.S. 1105 (2000). The Court interpreted Section 1981 to apply to independent contractors based on its language. Section 1981(b) defines the phrase "make and enforce contracts" to include "the making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship." The court concluded that the racially offensive actions of store officials resulted in a hostile environment, which also led to the termination of plaintiff's contract with the store.

Since Danco, more and more federal courts are applying Section 1981 to independent contractors. See Benton v. Cousins Props., Inc., 2002 U.S. Dist. LEXIS 23056, at *71 (N.D. Ga. 2002) ("Like the First Circuit, this Court will likewise assume that Congress did not omit independent contractors from coverage under amended Section 1981."); Webster v. Fulton County, 283 F.3d 1254 (11th Cir. 2002) (Independent contractor states a claim for violation of Section 1981 when contractor alleges that governmental entity refused to award contract in retaliation for contractor's filing of a lawsuit charging governmental entity with discrimination).

³² In Sistare-Meyer v. Young Men's Christian Ass'n, 58 Cal. App. 4th 10, 16-18 (1997), review denied (1998), the California Court of Appeals held that independent contractors did not have a right to bring a claim for wrongful termination in violation of public policy based upon the California Constitution.

Moreover, state anti-discrimination statutes may also protect independent contractors, as well as employees. For example, California Civil Code Section 51.5 is the state equivalent of 42 U.S.C. § 1981, although it covers more types of discrimination. The relevant section of the statute states:

No business establishment of any kind whatsoever shall discriminate against, boycott or blacklist, or refuse to buy from, contract with, sell to, or trade with any person in this state because of the race, creed, religion, color, national origin, sex, disability, or medical condition of the person or of the person's partners, members, stockholders, directors, officers, managers, superintendents, agents, employees, business associates, suppliers, or customers, because the person is perceived to have one or more of those characteristics, or because the person is associated with a person who has, or is perceived to have, any of those characteristics.

Very few cases have interpreted Section 51.5. Although Section 51.5 would appear to prohibit discrimination against independent contractors, no court rulings have confirmed this yet. One recent federal decision, Strother v. Southern Cal. Permanente Med. Group, 79 F.3d 859, 875 (9th Cir. 1996), held that someone in a partnership relationship could not bring a claim under Section 51.5 against another partner, reasoning that the statute “appears to be aimed only at discrimination in relationships similar to the proprietor/customer relationship” (*i.e.*, where the person claiming discrimination sought to buy something from the discriminator). Companies should be very cautious about relying upon this interpretation of Section 51.5. Since the statute specifically states that it applies to decisions to “refuse to buy from [or] contract with” another person or business (emphasis added), companies should not be surprised if future decisions interpret Section 51.5 to apply to discrimination against independent contractors.

B. Sexual Harassment

California law (apparently uniquely) provides a cause of action for independent contractors who suffer sexual harassment. California Civil Code Section 51.9 provides a cause of action where “there is a business, service, or professional relationship between the plaintiff and the defendant,” the plaintiff suffers sexual harassment, the plaintiff could not terminate the business relationship without difficulty, and the plaintiff suffers an injury. In 1999, Governor Davis signed into law Assembly Bill 519, which makes Civil Code Section 51.9 an even more powerful cause of action for independent contractors. Assembly Bill 519 made the following changes:

The independent contractor is no longer required to show that the sexual harassment continued after he or she requested it to stop;

- (1) the law now provides a cause of action when an “agent” of the defendant commits the harassment;

- (2) verbal, visual or physical conduct of a sexual nature, or hostile conduct based on gender is now enough to support a cause of action; previously sexual advances, solicitations, sexual requests or demands for sexual compliance were required;
- (3) the law previously stated that the plaintiff had to suffer “economic loss or disadvantage” or “personal injury” because of the harassment to sue; now the law provides specifically that an employee also can sue if he or she merely suffers “emotional distress or the violation of statutory or constitutional rights.”

C. **Discriminatory Harassment**

California’s employment laws also protect independent contractors from discriminatory harassment. The California Fair Employment & Housing Act (“FEHA”) protects, among other things, “person[s] providing services pursuant to a contract” from discriminatory harassment. Historically, FEHA had protected only traditional employees or applicants from harassment. Thus, if a secretary, who was an employee, and a computer programmer, who was an independent contractor, sat next to each other in an office, and both were subjected to racial harassment by a supervisor, the secretary could assert a FEHA claim while the computer programmer could not.³³ Now, it is equally unlawful under FEHA for employers to harass contract workers and employees based on race, religious creed, color, national origin, ancestry, physical disability, mental disability, medical condition, marital status, sex or age. Cal. Gov’t. Code § 12940(j)(1).

As defined by FEHA, a contract worker or, more precisely, “[a] person providing services pursuant to a contract,” is a person who meets all of the following criteria:

- 1) The person has the right to control the performance of the contract for services and discretion as to the manner of performance;
- 2) The person is customarily engaged in an independently established business; and
- 3) The person has control over the time and place the work is performed, supplies the tools and instruments used in the work, and performs work that requires a particular skill not ordinarily used in the course of the employer’s work. (Emphasis added.)

Cal. Gov’t. Code, § 12940(j)(5).

Although this definition of a “contract worker” is very similar to the traditional test for an independent contractor, it is noticeably more narrow. Under the traditional test, the worker’s right to control the manner of performance is normally sufficient (in and of itself) to make the worker an independent contractor. Under the FEHA definition, by contrast, in addition to having the right to control the performance and manner of performance, the worker also must be

³³ Bridge, Catherine, Assembly Bill Would Protect Contract Workers, The Recorder (May 12, 1999).

“customarily engaged in an independently established business,” have “control over the time and place the work is performed,” supply “the tools and instruments used in the work,” and “perform work that requires a particular skill not ordinarily used in the course of the employer’s work.” This definition leaves several situations in which FEHA will not protect particular independent contractors from harassment because the independent contractor neither qualifies as an employee or contract worker as defined by FEHA.

For example, assume Mr. Smith is a computer programming employee of Company A and, to earn extra money, works on the side as an independent contractor for Company B writing a computer program for a flat fee. Mr. Smith does not have his own business and he uses a Company B computer (which contains all necessary software) to write the computer program. FEHA apparently would not cover Mr. Smith because: (1) he is not an employee but an independent contractor; yet, (2) he does not meet FEHA’s definition of a contract worker because he is not engaged in an independently established business and he does not use his own tools and instruments to conduct the work.

Since the legislature probably did not intend to create this gap in FEHA coverage, the legislature may further amend FEHA to make its harassment provisions cover all independent contractors.

In the meantime, California courts seem to be willing to find ways to bridge the FEHA gap between employee and independent contractor, at least in sexual harassment situations. Specifically, in a recent case, the California Court of Appeal held that, although an individual was not an employee or a person providing services pursuant to a contract under FEHA, she was a "special employee," and therefore, had standing to assert a FEHA sexual harassment claim. Sallie Mae Bradley was temporarily working at a California prison as a licensed clinical social worker pursuant to a contract between the California Department of Corrections ("CDC") and the National Medical Registry. Bradley alleged she was harassed by the prison's chaplain and then was retaliated against when she complained about the harassment. The CDC argued that Bradley was neither an employee nor a person providing services pursuant to a contract, and as such, did not have standing to sue under FEHA. Because Bradley did not have the requisite control over the means by which she worked and was not hired to produce an end product, the court agreed with the CDC that Bradley was not providing services pursuant to a contract. The court further found that Bradley was not an employee. Nevertheless, the court held that Bradley was a "special employee," employed by both the CDC and the Registry, for FEHA purposes, and therefore, had standing to sue. The court stated that if it were to accept the CDC's argument that Bradley was neither an employee nor a person providing services pursuant to a contract, "there would be a large number of people working daily in our state prison system (and presumably in other state agencies) without protection under the FEHA. This is inconsistent with the legislative intent to expand FEHA protection to the largest number of individuals possible, including those who traditionally would be excluded from the employment relationship because they exercise complete control of the services provided." Bradley v. Department of Corrections & Rehabilitation, 158 Cal. App. 4th 1612, 1629 (2008).

D. W-2 Reporting of Contractor’s Income Could Trigger “Employee” Status

A law that took effect in California in January of 2000 provides that “there is a rebuttable presumption” that the term “employer” under FEHA “includes any person or entity identified as the employer on the employee’s federal form W-2 (wage and tax statement).” Cal. Gov’t. Code § 12928. Sometimes companies incorrectly withhold wages and issue W-2 forms for independent contractors. Issuing a W-2 to a contractor could have the effect of giving the contractor all of the rights of an employee to sue for discrimination under FEHA. As a general rule, independent contractors may not sue companies under FEHA unless the claim is for discriminatory harassment (i.e., they cannot sue for discriminatory terminations, non-promotion, compensation, etc.). There are many close cases where it is unclear whether a worker is an employee or a contractor and the W-2 form presumption could be determinative in those cases.

E. EDD Reporting Requirements

Effective January 1, 2001, companies have expanded reporting obligations to the Employment Development Department (“EDD”) regarding independent contractor earnings data. The reporting obligations apply only if and when the aggregate payments to the contractor equal or exceed \$600 in any year, or a contract is entered into that provides for present or future payments to the contractor of at least \$600 in any year. Cal. Unemp. Ins. Code § 1088.8(c). As soon as either of the above events occurs, the company must within 20 days submit a report to EDD that includes particular information about the contractor.

The law contains explicit restrictions as to the circumstances under which the EDD may release the above information. Specifically, the information may be released only for purposes of establishing, modifying, or enforcing child support obligations, and for child support collection purposes as provided in the tax code. Cal. Unemp. Ins. Code § 1088.8(e). The law prohibits the EDD from using this information for any other purpose. Nonetheless, knowledge by the EDD of specific details of employer-independent contractor contracts and relationships could prompt an audit by that entity as to the classification of the employer’s workers. Cal. Unemp. Ins. Code §1088.8(e). As such, employers should view this law as a call to verify that their workers are properly classified.

VI. PROCEDURES IF THE WORKER’S STATUS IS NOT CLEAR

Often, it may not be clear whether the worker is a bona fide independent contractor or perhaps inadvertently converted to employee status. Indeed, the case may involve “good” and “bad,” or at least “muddy facts.” Since actions speak louder than words, many companies have concluded that there needs to be some centralized corporate coordination to conform the working relationship to the language of an independent contractor agreement and minimize risk by controlling carefully the manner in which the company receives the services of independent contractors. A mutual desire to avoid employment taxes and withholding is not in and of itself sufficient to create an independent contractor relationship.

Many companies have accordingly found it advisable to have either a centralized corporate independent contractor “clearing house” or a set of established procedures to determine who may be retained as an independent contractor. Such procedures are particularly well suited to those situations in which there is a managerial tendency to accommodate workers who wish to avoid employee status and be characterized as independent contractors while they function in

fact as employees. The employer can incorporate the various factors--or the most stringent statement of factors taken from the various contexts--into written guidelines. Indeed, many corporations--particularly those using "technical service employees"--are creating formal written policies for the selection and use of independent contractors, using Revenue Ruling 87-41 as guidance. An independent contractor "self audit," discussed below and attached hereto as **Attachment D**, is one example of a concrete procedure employers can use to aid their classification of service providers.

VII. PRACTICAL TIPS TO MINIMIZE RISK OR DRAFT AN INDEPENDENT CONTRACTOR AGREEMENT

The fact that the agencies and the courts judge the contractor's relationship to the company by actions, rather than expressed intentions, should not dissuade the employer from using some care to draft an independent contractor agreement. **Attachment E** is a sample Independent Contractor agreement companies may modify and implement with their independent contractors. Courts also tend to look closely at the agreement, where one is in evidence. In addition, the claim of an independent contractor relationship is strengthened if the parties take the time to reduce their understanding to writing.

The regulatory tests for an independent contractor relationship offer some obvious suggestions for contractual terms. The same terms can serve as a cautionary list in those circumstances in which a formal agreement is not used but the company nonetheless wishes to retain the services of an independent contractor while minimizing legal risks. The most important terms to consider include:

- 1) A statement that the contractor is an independent contractor and not an employee, and that the parties understand and intend such a relationship;
- 2) A statement to the effect that the contractor, not the employer, has the right to control how the project is to be accomplished; if the worker truly is an independent contractor, the employer's only legitimate actions will be to insure that the product meets specifications, not control the means of production;
- 3) A provision for payment by the project, where feasible, and not by increment of hour, day or week;
- 4) A provision that the contractor supply all tools and equipment, if possible (and the workplace, if applicable);
- 5) A provision specifying methods, rights and consequences of termination by either party;
- 6) A statement that the contractor shall pay all out-of-pocket expenses of the project, such as telephone calls, copying costs and travel;
- 7) A statement that the contractor shall be responsible to account for all taxes for itself and contractor's own employees;

- 8) A provision requiring the contractor to provide workers compensation coverage for its employees (or a provision making the contractor a special employee for the purpose of workers' compensation coverage only) and any legally required benefits;
- 9) A provision expressly exempting the contractor from all employee benefits; and
- 10) A cut-off date for the agreement, if the nature of the relationship demands that the agreement be open-ended instead of project-based.

The decision in Borello, supra, cautions that an "employee" cannot waive the benefits of state social legislation, specifically workers' compensation coverage. Contractual language does not control if the agreement does not truly reflect an independent contractor relationship. Ultimately, the essence of the relationship--whether independent contractor or employee--will be revealed by a review of the facts unique to the relationship established against the legal standards of the particular statute of interest.

VIII. MANAGING THE RISK OF A CONTINGENT WORKFORCE

A myriad of different employment law and human resources operations questions arise when a "supplier" company contracts with a "host" company to supply it with workers on-site at the host company's premises. For example:

- (1) Who is liable if the host company refuses to pay overtime to non-exempt employees of the supplier company due such compensation?³⁴
 - Would it change your answer if you were to conclude that the federal Fair Labor Standards Act ("FLSA") does not impose joint and several liability for violations of the FLSA?
 - Would it change your answer if you discovered facts which suggested the "host" company enjoyed a de facto "joint-employer" relationship with the supplier company? (See Attachment A, at column 3: "Independent Contractor Models," which illustrates this concept).
- (2) Who is liable if a "host" company manager is surprised to discover the "supplier" company employee just sent over to work on-site at the "host" company has a physical impairment the "host" manager cannot or refuses to accommodate?

³⁴ The FLSA defines an "employer" to include: ". . . any person acting directly or indirectly in the interest of an employer in relation to an employee and includes a public agency, but does not include any labor organization (other than when acting as an employer) or anyone acting in the capacity of officer or agent of such labor organization." Accordingly, overtime and minimum wage liability attaches to an "employer," and not third parties.

Would your answer change if you were to conclude that Title I (applicable to employment) of the American with Disabilities Act of 1990 (“ADA”) makes an employer jointly and severally liable for unlawful acts against an employer’s employee.³⁵

- (3) Who is liable if a “host” company employee sexually or racially harasses the “supplier” company’s employee on-site at the “host” company?

Does it matter if the “host” company harasser is a manager or only an employee?

Does it change your answer if I were to advise you that some courts have interpreted Title VII of the 1964 Civil Rights Act to include a so-called “interference” clause? See EEOC 12/03/97 “Enforcement Guidance: Application of EEO Laws to Contingent Workers Placed by Temporary Employment Agencies and Other Staffing Firms”, at pp. 9-10 and footnote 17 (at p.29).

A. Legal Framework For Analysis

- 1) Generally, “employers” only liable. With certain exceptions (i.e. the recently amended California FEHA), most employment law statutes only provide for “employer” obligations to “employees”.
- 2) Joint-Employer Work Around. The joint employer doctrine, addressed above, avoids the roadblock that a third party is not the employee’s employer by finding that a third party company is the employee’s employer simultaneously in time the employee is also an employee of the other employer.
- 3) “Interference Clause” Work Around. Title VII, the ADA and the Age Discrimination in Employment Act (“ADEA”), however, may also make it unlawful for an employer to discriminate against “an individual” and not just the employer’s employees.³⁶ This is the so-called “interference” clause prohibiting an employer (i.e. “host” company) from interfering with an individual’s employment by the “supplier” company (perhaps by subjecting the individual to unlawful discrimination).

³⁵ See for example, 42 U.S.C. § 12112

(a) General rule

“No covered entity shall discriminate against a qualified individual with a disability because of the disability of such individual . . .

(b) Construction

as used in subsection (a) of this section, the term ‘discriminate’ includes-

(2) participating in a contractual or other arrangement or relationship that has the effect of subjecting a covered entity’s qualified applicant or employee with a disability to the discrimination prohibited by this subchapter (such relationship includes a relationship with an employment or referral agency, labor union, an organization providing fringe benefits to an employee of the covered entity, or an organization providing training and apprenticeship programs) . . .”

³⁶ See 42 U.S.C. § 2000 e-2(a) (Title VII), 29 U.S.C. § 623 (a) (ADEA), and 42 U.S.C. § 12112(a) (ADA).

- 4) “Agent of the Employer” Work Around. An “employer” may be liable for the actions of its “agents.” Depending upon the facts, a “head hunter,” union or temporary employment firm could be an agent of the employer.³⁷
- 5) Third Party “Tort” Liability Work Around. Depending upon the facts, an employee may sue a third party (i.e., a “host” company) in tort even though the worker is a statutory employee of his/her employer (i.e., the “supplier” company).³⁸
- 6) Third Party Interference with Contract Liability Work Around. Depending upon the facts, an employee may sue a third party (i.e., perhaps a manufacturer) in *contract* for interfering with the employee’s employment with the “supplier” company.³⁹

B. Employer Responsibility For Third Party Recruiters, “Temp Agencies” And “Headhunters”

Employers which outsource their recruitment and hiring procedures should exercise caution since they may be jointly and severally liable for any unlawful recruitment and selection procedures their delegate may occasion. While many “temp agencies” source only “independent contractors” for the host company, many “temp agencies” also source employees or temporary service workers who the host company converts to employee status at the host company.⁴⁰ The federal government actively monitors recruitment practices, and even an unintended, discriminatory impact on minorities or women in the selection process can lead to substantial potential economic liability for back pay damages.

For example, while UGESP’s record retention and documentation procedures do not reach recruitment practices, both Title VII and Executive Order 11246 make discrimination in recruitment (among other things) unlawful. In Abron v. Black & Decker, 654 F.2d 951 (4th Cir. 1981) the court affirmed a lower court’s finding that Black & Decker had engaged in unlawful discriminatory recruitment, hiring and promotion practices violative of Title VII of the 1964 Civil Rights Act. In that case, the court found that Black & Decker had deliberately avoided recruiting at predominantly Black high schools in the Baltimore area. Instead, the company either recruited at mainly white high schools, or accepted referral applications from friends of current (primarily Caucasian) employees. As a result of its recruitment practices, only 3% of

³⁷ Generally, an agent of the employer is one which it has a right to control.

³⁸ Thus, while workplace injuries may, for example, be subject to the exclusive remedies of the workers compensation code and the Occupational Safety and Health Act (“OSHA”) as to the employee’s employer, the employee can nonetheless sue third party manufacturers (perhaps of defective equipment) in tort for alleged negligence.

³⁹ In California, a tort cause of action for “intentional interference with contractual advantage” will lie when (a) there is a culpable intent to cause the breach; (b) plaintiff’s performance of the contract is more expensive or burdensome, or interferes with the formation of a prospective or existing economic relationship by unlawfully disrupting same). See Savage v. PG&E, 21 Cal. App. 4th 434 (1993); Seaman’s Direct Buying Service, Inc. v. Standard Oil Company of California, 36 Cal. 3d 752 (1984).

⁴⁰ I can find no case law authority addressing the liability, or absence thereof, of a host company for a recruitment company’s unlawfully discriminatory recruitment of workers who are independent contractors unto the host company preliminary to the host company “rolling them over” to regular employment at the host company.

Black & Decker's workforce in 1977 was Black, while 22% of the labor force in the surrounding area was Black. *Id.* at 956.

Furthermore, the so-called and little known *nondelegable duty doctrine* (which is different from the "*agency*" doctrine) generally prevents an employer from avoiding liability for discrimination by attempting to delegate the recruitment, hiring and/or promotion procedures to a third party. Rather, various courts have settled the question by holding that liability for discriminatory recruitment and hiring practices must rest with the employer itself because these are core corporate powers being exercised the responsibility for which public policy prevents the employer from delegating to third parties.

In *Powers v. Alabama Dep't of Education*, 854 F.2d 1285 (11th Cir. 1988), the State of Alabama Department of Education's Disability Determination Service ("DDS") delegated its promotion selection process to the Personnel Board of the State of Alabama ("SPD"). The SPD gathered and ranked applicants on the basis of three criteria: (1) 45% based on applicant's training and education; (2) 45% on experience, the length of time an applicant had worked in disability determination, and the positions in which he or she had served [this 90% formed the 'training and experience' or 'T&E' score]; and (3) 10% based on supervisor evaluations while at DDS. The SPD then further culled applicants, placing the most desirable candidates on a list of "Certificate of Eligibles." The DDS then only considered such "eligible" applicants for promotion. Plaintiffs alleged that the T&E evaluation criteria (worth 90% of the total promotion criteria) had a disparate impact on Black applicants.

The Eleventh Circuit Court of Appeals rejected the DDS' attempt to avoid liability by alleging that it had delegated its promotion mechanism to the SPD. The Court held that "an employer cannot delegate several aspects of its promotion procedure to another agency such as SPD and then escape liability if that agency develops discriminatory practices." *Id.* at 1294. The Court further reasoned that "Title VII's remedial purpose requires that an employer be held accountable for practices it, in effect, adopts if those practices have a class-wide discriminatory impact. To hold otherwise would run contrary to cases holding employers responsible for the use of discriminatory tests developed and administered by an outside agency." *Id.*

The federal courts nationwide have followed the nondelegable duty doctrine the *Powers* court approved thus sending a message to employers that they are ultimately responsible for non-discrimination in their hiring and promotion procedures for employees:

Moskowitz v. City of Chicago, 1993 U.S. Dist LEXIS 16402, *10-11 (N.D. Ill. 1993) ("[U]nder either Title VII or the ADEA, an employer cannot simply delegate portions of its hiring or promotion procedure to a third party and escape liability if the third party develops discrimination problems.");

Scott v. City of Topeka Police and Fire Civil Service Comm'n, 739 F. Supp. 1434, 1438 (D. Kan. 1990) ("To hold that the City of Topeka could avoid liability for employment discrimination by delegating certification decisions to a commission would be contrary to the broad scope of the definition of "employer" under Title VII and would eviscerate Title VII's protection for municipal employees. Therefore, the court finds that the City of Topeka can be

held liable under Title VII for the gender discriminatory practice of its Police and Fire Civil Service Commission in this case.”);

Terbovitz v. Fiscal Court of Adair County, 825 F.2d 111, 116 (6th Cir. 1987) (disapproved on other grounds) (holding, in a case involving hiring for emergency medical technician positions, that “[a]n employer . . . may not avoid Title VII liability by delegating its discriminatory programs to third parties.”);

Town of South Whitley v. Cincinnati Ins. Co., 724 F. Supp. 599, 603-04 (N.D. Ind. 1989) (holding that town and its governing board acted as a single entity in not hiring employee, because governing board exercised so much authority in the name of the town [including setting town employee salaries, hiring and firing town employees]);

Eldredge v. Carpenters 46 Northern Cal. Counties Joint Apprenticeship and Training Ctte., 833 F.2d 1334, 1337 (9th Cir. 1987) (“[The joint labor-management committee] cannot avoid liability for the effects of its own admission procedures by pointing to the discriminatory practices of those to whom it has delegated the power to select apprentices.”);

Lam v. Univ. of Hawaii, 40 F.3d 1551, 1561 (9th Cir. 1994) (“...where a university has delegated employment decisions to a committee and members of that committee have engaged in discriminatory treatment, the university is liable.”).

Employers should actively ensure that their hiring and promotion procedures of employees, even if carried out by third parties, neither disparately treat nor impact members of protected classes. In August 2005, for example, the Whirlpool Corporation paid \$850,000 in back wages to settle claims OFCCP brought that Whirlpool unlawfully discriminated against approximately 800 African-American job applicants. Although it admitted no fault in the settlement, Whirlpool also agreed to offer jobs to 48 rejected applicants.

The OFCCP conducted a routine audit of Whirlpool and alleged that, in the time period between March 1997 and February 1998, the use of the Test of Adult Basic Education (“TABE”) as a selection device⁴¹ – which test features multiple-choice questions that test math, reading, and English skills – disproportionately excluded Black applicants for entry-level positions at Whirlpool’s Tulsa manufacturing facility, and for other promotions within the company. At the heart of the OFCCP’s investigation and prosecution was its finding that several of the skills that the TABE tested were not necessary to the entry-level jobs at issue.

Moreover, while the nondelegable duty doctrine is alive and well, it is also clear that a state agency that performs an employer’s hiring functions generally will not be considered that employer’s agent, because the essential requirement of *control* over the agent is typically absent. In other words, the existence of an agency relationship depends on the principal’s right to control the agent, and in the case of an employer principal and state entity agent, there typically is not

⁴¹ Notably, Whirlpool did not directly administer the TABE to its candidates. Rather, the Tulsa Technology Center, a county agency, administered the TABE on Whirlpool’s behalf. Nonetheless, as discussed further below, OFCCP alleged that Whirlpool was responsible for any discrimination in the (state entity third-party’s) administration of the TABE.

enough control over the state entity to constitute a true agency relationship.⁴² Accordingly, employers will attempt to frame disputes regarding third party administration of recruitment and selection in terms of “agency” law.

In Mickel v. South Carolina State Employment Service, 377 F.2d 239 (4th Cir. 1967), for example, the South Carolina State Employment Service (“SES”) administered and applied tests and standards that the employer (Exide Corporation) prescribed. The State then referred qualified applicants to the employer. Stated differently, at most, the SES did what state employment services typically do, which is to screen applicants and put employers in touch with qualified applicants. Typically, “[t]he employer then interviews the applicant and does its own hiring.” Id. at 241.

In holding that Exide did not sufficiently control the at-issue state agency to be its agent in the context of discriminatory hiring, the Fourth Circuit concluded that the theory of an “agency relationship” was “utterly lacking in merit. There is no indication, by affidavit or otherwise, that the State Employment Service acted as Exide's agent to implement an Exide purpose of invidious discrimination.” Id.⁴³ The court further reasoned that “[o]rdinarily, the primary function of a state employment service is to assist applicants in securing employment, rendering a screening service for employers, and put employer and employee into contact. The employer then interviews the applicant and does its own hiring . . . such a relationship falls short of that of principal and agent.” Id.

The role of the SES in Mickel vis-à-vis the employer is typical of such relationships. Customarily, the state agency will administer initial screening mechanisms, and then forward qualifying individuals to the employer for final evaluation and selection. Such an interaction, without more, typically will not create an agency relationship. Nonetheless, an employer is well advised to ensure that any recruitment, hiring or promotion procedures related to its workforce is devoid of discriminatory intent and impact.

Indeed, employers should consider imposing some or all of the below clauses in their contracts with third party vendors (headhunters; “temp” agencies and state unemployment security commissions) where the marketplace will so permit.

(1) EXEMPLAR COOPERATION CLAUSE

Supplier agrees to reasonably cooperate with [Host Company] at all times during and after the Term of this Agreement regarding the investigation of, response to or defense of any complaints, grievances, claims or causes of action of any kind raised by or on behalf of current or

⁴² Traditionally: (1) **agency** is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and *subject to his control*, and consent by the other so to act; (2) the one for whom action is to be taken is the principal; and (3) the one who is to act is the agent. Restat 2d of Agency, § 1 (emphasis added).

⁴³ Importantly, the Mickel court stated that they were not holding that “there could never be a set of facts or circumstances under which a state instrumentality could become the agent of a private corporation so as to make the latter responsible for violation of the federal statutes by the state agency.” Id.

former employees of Supplier in any forum or context arising out of, related to or connected with the Supplier's employees' services to [Host Company]. Supplier's cooperation shall include, but not be limited to, the following: (i) assistance to [Host Company] with gathering evidence relevant to such complaints, grievances, claims or causes of action, and (ii) retention (during, and for at least ___ years following the expiration of, the Term of this Agreement) of clear and complete "applicant flow" and "personnel records" (as defined more fully herein) for Supplier's applicants and employees.

(2) EXEMPLAR ADVERSE IMPACT DATA COLLECTION

Supplier agrees, throughout the Term of this Agreement, to collect and report to the _____ [position title] of [Host Company] on a semi-annual basis, appropriate and complete adverse impact information and underlying raw data related to the hiring, promotion, termination and length of time to termination for all positions within [Host Company] to which Supplier assigns its employees to provide services.

(3) EXEMPLAR DISCRIMINATION PROHIBITION CLAUSE

Supplier agrees that, throughout the Term of this Agreement, it will comply with all applicable federal, state and local laws which prohibit discrimination in employment, and it will take reasonable and appropriate measures to avoid discrimination against Supplier's employees while providing services to [Host Company].

(4) EXEMPLAR INDEMNITY CLAUSE

Supplier will defend, indemnify, and hold [Host Company], its parent, affiliated entities, and each of their respective affiliates and directors, officers, employees, agents and each of their respective successors and assigns, harmless against all claims, liabilities, losses, damages, costs and expenses of any nature (including but not limited to reasonable attorneys' fees and costs of suit) arising out of, resulting from or related to the injury or death of or harm to any person, or damage or loss of any property allegedly or actually arising out of, resulting from or related to any act, omission, negligent work or Wrongful Employment Practice (as defined below) of Supplier or its employees, agents, or subcontractors in connection with performing

this Agreement unless such claims, liabilities, losses, damages, costs or expenses arise solely from the gross negligence or willful misconduct of [Host Company] or its employees.

“Wrongful Employment Practice” means any actual or alleged:

- (a) violation of any federal, state, local or common law, prohibiting any kind of employment-related discrimination;
- (b) harassment, including any type of sexual or gender harassment as well as racial, religious, sexual orientation, pregnancy, disability, age, or national origin-based harassment and including workplace harassment by non-employees;
- (c) abusive or hostile work environment;
- (d) wrongful discharge or termination of employment, whether actual or constructive;
- (e) breach of an actual or implied employment contract;
- (f) wrongful failure or refusal to hire or promote, or wrongful demotion;
- (g) wrongful failure or refusal to provide equal treatment or opportunities;
- (h) defamation, libel, slander, disparagement, false imprisonment, misrepresentation, malicious prosecution, or invasion of privacy;
- (i) wrongful failure or refusal to adopt or enforce adequate workplace or employment practices, policies or procedures;
- (j) wrongful, excessive or unfair discipline;
- (k) wrongful infliction of emotional distress, mental anguish, or humiliation;

- (l) retaliation, including retaliation for exercising protected rights, supporting in any way another’s exercise of protected rights, or threatening or actually reporting wrongful activity of an Insured such as violation of any federal, state or local “whistleblower” law; or
- (m) negligent hiring or negligent supervision of others in connection with (a) through (l) above.

C. Does Either The “Host” Or “Supplier” Company Enjoy A Right Of Indemnity, As A Matter Of Law?

In the absence of an express *contractual* right of indemnity running between the “host” and “supplier” company, state law contract law may give rise between “host” and “supplier” companies to *implied* indemnities as to both “loss” and the cost of defense. As an example, we discuss below California state law.

1. Express and Implied Indemnity

Under California law, a right of indemnity is either express⁴⁴ or implied.⁴⁵ Express indemnity arises by written contract, and operates to effect a complete shift of the loss from the indemnitee to the indemnitor.⁴⁶ Thus, express indemnity is an “all or nothing” right of indemnity.

Implied indemnity, by contrast, is judicially created and finds its source in equitable considerations brought into play either by contractual language not specifically dealing with indemnification or by the equities of the particular (tort)⁴⁷ case.⁴⁸ Implied indemnity, unlike express indemnity, is based on principles of comparative fault.⁴⁹ Thus, implied indemnity

⁴⁴ Cal. Civ. Code §§ 2772-2784.5 govern the interpretation of express indemnity agreements. Cal. Civ. Code §§ 1549-1701 also generally govern interpretation of express indemnity agreements. Public policy limitations on contracts for indemnity are set forth in Civil Code § 1668 (contracts for exempting one from liability for fraud, willful injury, or violation of law), 2773 (agreement indemnify against unlawful act), 2782-2782.5 (construction contracts), and 2784.5 & hauling, trucking, or cartage contracts).

⁴⁵ The right of *implied* indemnity in contract is a judicially created doctrine. See American Motorcycle Assn. v. Superior Court, 20 Cal. 3d 578, 598 (1978). The term “implied indemnity” is also sometimes referred to as “equitable indemnity” or “comparative indemnity,” or any combination of the three.

⁴⁶ Rodriguez v. McDonnell Douglas Corp., 87 Cal. App. 3d 626, 676 (1978).

⁴⁷ All the law we could find in California imposing implied indemnity obligations arose in the context of “tort” liability, and did not spring from statutory causes of action (whether joint and several liability arose under the statute or not.) We assume, however, there is no impediment to an implied indemnity arising from statute.

⁴⁸ Bay Development Ltd. v. Superior Court, 50 Cal. 3d 1012, 1028-1029 (1990).

⁴⁹ American Motorcycle Assn. v. Superior Court, 20 Cal. 3d 578, 598 (1978). In American Motorcycle, the California Supreme Court restructured the right of implied indemnity from a method to effect a complete shift of loss depending on relative degrees of culpability, to a method to achieve equitable apportionment of loss among multiple tortfeasors based on principles of comparative fault.

includes the entire range of possible apportionments of loss, from no right to any indemnity, to a right to partial indemnity, to a right to complete indemnity.⁵⁰

In addition, the doctrine of partial implied indemnity applies even if one of the tortfeasors is held liable on a strict liability theory and the other tortfeasor is held liable only for negligence.⁵¹

For either express or implied indemnity, it is important to note that indemnity rights do not accrue until the indemnitee suffers actual “loss” by paying a claim. Thus, there is no right of indemnity if the *indemnitee* is not liable to the plaintiff.⁵² In addition, there is no right of indemnity if the *indemnitor* is determined to have no liability to the plaintiff.⁵³ Therefore, as a practical matter, there is no right to indemnity unless and until there has been a “loss” by both the indemnitor and the indemnitee.

2. Proceedings To Enforce Indemnity Rights

Any party may obtain a determination of indemnity rights by filing a cross complaint for declaratory relief in an action brought by a third party, prior to the final disposition of the proceedings.⁵⁴ In addition, an indemnitee may also enforce indemnity rights in a subsequent action after paying the underlying claim.⁵⁵ In either event, the parties should use a special verdict asking the trier of fact to apportion the respective percentages of fault between the parties, therefore obviating the need for a separate determination of fault apportionment after the conclusion of the underlying matter.

3. Award of Attorney’s Fees

If a co-defendant is found to be without fault and prevails in the underlying action, the party has not suffered “loss,” and therefore, cannot prevail on a claim for indemnity against the party at fault.⁵⁶ The prevailing co-defendant, however, may seek attorney’s fees incurred in defending the third-party litigation.⁵⁷ Pursuant to Code of Civil Procedure Section 1021.6, a court may award attorney’s fees to a party that prevails on a claim for implied indemnity if, on motion, the court reviews the evidence in the principal case and finds that: (1) the bad act of the indemnitor required the indemnitee to act in protection of its interests by defending an action by a third party; (2) the indemnitor was properly notified of the demand to provide a defense on behalf of the indemnitee and did not do so; and (3) the trier of fact determined that the indemnitee was without fault in the underlying case that the indemnitee has a final judgment entered in its favor granting a summary judgment, a nonsuit, or a directed verdict.

⁵⁰ Far West Financial Corp. v. D&S Co., 46 Cal. 3d 796, 808 (1988).

⁵¹ Safeway Stores, Inc. v. Nest-Kart, 21 Cal. 3d 322 (1978).

⁵² Woodward-Gizienski & Associates v. Geotechnical Exploration Inc., 208 Cal. App. 3d 63 (1989).

⁵³ Allis-Chalmers Corp. v. Superior Court, 168 Cal. App. 3d 1155, 1157-1159 (1985).

⁵⁴ See Valley Circle Estates v. VTN Consolidated, Inc., 33 Cal. 3d 604, 611-612 (1983) (noting that proper form of cross complaint for indemnity is one for declaratory relief).

⁵⁵ E.L. White, Inc. v. City of Huntington Beach, 21 Cal. 3d 497, 506 (1978).

⁵⁶ See Woodward-Gizienski & Associates v. Geotechnical Exploration Inc., 208 Cal. App. 3d 63 (1989).

⁵⁷ California Code of Civil Procedure Section 1021.6.

IX. CONDUCTING AN INDEPENDENT CONTRACTOR SELF-AUDIT

Employers increasingly recognize the potential liabilities and obligations created by the misclassification of a worker as an independent contractor. An incorrect assessment may result in years of litigation and unexpected contract, tax, wage and benefit liabilities. The failure by corporate management to appreciate, recognize and correctly classify independent contractors can produce disastrous results.

The continued use of independent contractors and the potential for significant liability mandates that companies take preventive measures to minimize the prospect of litigation. This self-audit is designed to aid companies to determine whether a “true” independent contractor relationship exists with members of its contingent workforce. This audit is designed to identify potentially problematic relationships and to raise important questions regarding the use of independent contractors. Although some of these issues may already be self-evident, this audit serves to focus attention on deficiencies and potential problems that companies overlook but need to address and solve. Of course, there may be issues that are not included in this self-audit which are important to your organization. Therefore, we recommend that you incorporate issues specific to your company.

Issues and problems raised by this audit may require consultation with legal counsel to ensure that your companies’ classifications comply with state and federal law. Consequently, careful analysis under this audit, before legal consultation, can greatly reduce the time and expense of having legal counsel review your contingent workforce from “square one.”

When conducting an audit, companies should recognize that discussions and notes may be subject to discovery in subsequent litigation. Litigants could use this audit as a “road map” to areas of weakness in your classifications, or even to prove liability. However, companies may be able to use several privileges to limit access to audit information if it properly invokes those privileges. Nevertheless, as is apparent from the discussion below, these privileges apply in only limited circumstances, and may be extremely difficult to satisfy. Prudent companies will therefore conduct this audit as though the information obtained will be discoverable.

A. Self-Critical Analysis Privilege

One privilege to limit access to information is referred to as the “self-critical analysis” privilege. The self-critical analysis privilege is recognized as a qualified privilege which protects certain critical self-appraisals. It allows individuals or businesses to candidly assess their compliance with regulatory and legal requirements without creating evidence that may be used against them in future litigation. The rationale for the doctrine is that such critical self-evaluation fosters the compelling public interest in observance of the law. A corporation that knows its evaluations will remain confidential will be more likely to self-audit and thereby produce more candid and accurate evaluations. Accordingly, the company could proactively prevent violations and discover minor infractions before they develop into major litigation.

Not all courts recognize or accept the “self-critical analysis” privilege.⁵⁸ Even courts that recognize the “self-critical analysis” privilege hold that a parties’ need for relevant evidence

⁵⁸ Compare Sheppard v. Consolidated Edison Co., 893 F. Supp. 6, 7-8 (E.D.N.Y. 1995) (prohibiting discovery of

may outweigh the risk that disclosure will impede self-evaluation.⁵⁹ Thus, courts hold that plaintiffs are entitled to discovery of documents where the information is necessary to prove the parties' case.

B. Attorney-Client Privilege

The attorney client privilege normally protects communications, made in confidence, to an attorney, by a client, for the purpose of seeking or obtaining legal advice. Its purpose is to promote freedom of consultation, to encourage clients to be completely truthful, and thus to assist the attorney in giving competent legal advice. Attorneys are sometimes the best auditors, particularly where an understanding of complex legal considerations is critical to determining the "true" nature of a worker. However, where an attorney conducts an audit, the parties must recognize a risk that that the attorney will be deemed to be acting in a role other than as counsel, and that neither the attorney's efforts nor communications between the attorney and company management will be legally privileged.

The attorney-client privilege does not automatically attach simply because an attorney is involved in an audit. Rather, you must observe certain procedural formalities; both with respect to the inclusion of inside or outside counsel.⁶⁰

The privilege generally applies in federal courts when the party asserting the privilege can show:⁶¹

- (1) a professional relationship exists between the attorney and the corporation;
- (2) the communication involves information needed for the attorney to provide the corporation with legal representation;
- (3) the company was aware at the time the communication was made that the information was being given to the attorney so the attorney could provide the company with legal services or advice; and
- (4) the company intended the communications to remain confidential.⁶²

Accordingly, to properly invoke the privilege, the company should do, at least, the following:

defendant company's audit but allowing discovery on the underlying factual underpinnings), with Holt v. KMI-Continental, Inc., 95 F.3d 123, 134, cert. denied, 520 U.S. 1228 (2nd Cir. 1996) (Title VII provides no support for the self-critical analysis privilege).

⁵⁹ See Hardy v. New York News, Inc., 114 F.R.D. 633, 641-642 (S.D.N.Y. 1987).

⁶⁰ Documents sent to an attorney who worked in the company's Employee Relations Department are not necessarily covered by the attorney-client privilege in the absence of proof that the same were "intended to be confidential", or that the "dominant purpose of the communication was to obtain legal advice", Governale v. Airborne Express, Inc., 1997 U.S. Dist. LEXIS 7562 (E.D.N.Y. 1997); See also USPS v. Phelps Dodge Refining Corp., 852 F. Supp. 156, 160 (E.D.N.Y. 1994) ("The mere fact that a communication is made directly to an attorney, or an attorney is copied on a memorandum, does not mean that the communication is necessarily privileged.")

⁶¹ Some state codes impose additional or other procedures and protocols applicable to state court matters.

⁶² UpJohn v. United States, 449 U.S. 383 (1981).

- a. A person within the company with sufficient authority to ask attorneys for legal advice and/or to act upon legal advice received should request the assistance of counsel. (Preferably, this is done through a short written communication to the lawyer creating a record memorandum to file of the precise date after which all protected communications would be subject to the privilege.)
- b. Once the privilege is invoked, non-lawyer corporate managers within the company should report to the company's legal department or to outside counsel thereafter, taking instruction from counsel, or counsel's agents (i.e., investigators, paralegals, etc.).
- c. It is useful to recite, from time to time, that the matter under consideration is proceeding pursuant to the need for legal advice. For example, auditors could begin or end written reports (not only addressing them to counsel) but also requesting counsel to advise what appropriate legal options exist in light of the developing facts. Similarly, counsel should direct the non-lawyer corporate auditor to gather appropriate facts "to allow counsel to give appropriate legal advice to the company".

It is also important to note that the privilege protects only communications and does not prevent the disclosure of underlying facts.⁶³ It is also necessary that the company not "waive" the privilege by communicating the information to third parties other than those to whom disclosure would be made in furtherance of the rendition of professional legal services to the client or those reasonably necessary for transmission of the communication.

C. Attorney Work Product

Separate from the attorney-client privilege is protection of "attorney work product". The "work product doctrine" protects from discovery the documents, reports, communications, memoranda, mental impressions, conclusions, opinions, or legal conclusions counsel prepares *in anticipation of litigation or for trial*.⁶⁴

Like the attorney-client privilege, the work product doctrine is subject to waiver and does not protect factual information in preparation of the lawsuit. The United States Supreme Court has yet to clarify whether the attorney work product doctrine is "absolute" or whether it is only a

⁶³ UpJohn v. United States, supra, 449 U.S. at 395; In re: Six Grand Jury Witnesses, 979 F.2d 939, 944 (2nd Cir. 1992) (Communications between attorney and client regarding an internal investigation were privileged, but factual information contained in written communications, including the results of investigation, were not shielded from discovery); Clarke v. American Commerce Nat'l Bank, 974 F.2d 127, reh'g denied, 977 F.2d 1533 (9th Cir. 1992) (detailed billing statements of counsel not protected by attorney-client privilege. Federal common law allowed discoverability of identity of a client, the amount of the fee, identification of payment by case file name and the general purpose of the work. However, billing statements which revealed the client's motive to seek representation, litigation strategy or the specific nature of those services (for example, the area of law researched) fell within the attorney-client privilege).

⁶⁴ See Hickman v. Taylor, 329 U.S. 495, 507-08 (1947); Fed. R. Civ. P. 26(b)(3). The attorney work product doctrine allows counsel to prepare his/her case without undue and needless interference.

“qualified” privilege, and if so, what standards may apply to permit a party litigant to discover opposing counsel’s “work product” prepared in anticipation of litigation or trial.⁶⁵

After reviewing the preceding issues and concerns, it is evident that conducting a self-audit is a significant task. The limitations of this section make it impossible to raise every issue and, therefore, employers should include all other issues of importance to their companies in their self-audit. Nonetheless, the short-term effort of conducting such an audit yields important long-term gains by identifying problems that companies need to address.

This audit is only the first step in preventing and confronting the misclassification of workers. Once companies identify problems, they must act to correct policies, procedures, and practices that are inconsistent with legal requirements. This audit must not be regarded as a one-time event, but rather as an ongoing process that must be engaged in with regularity as circumstances change.

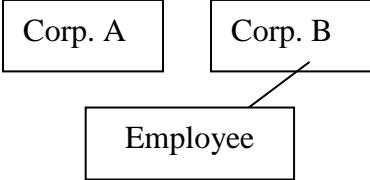
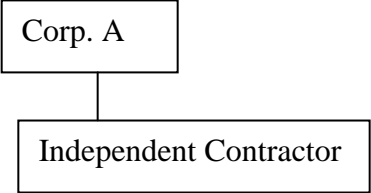
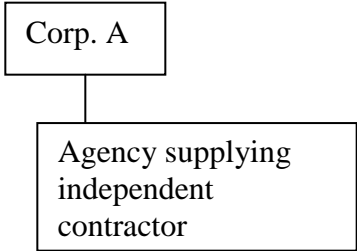
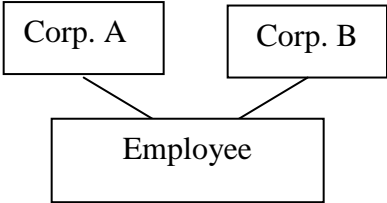
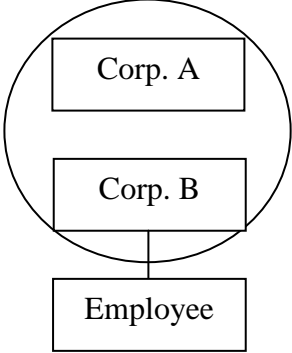
ATTACHMENTS

- Attachment A:** Independent Contractor Models
- Attachment B:** Comparison Of IRS Twenty-Factor Tests To Three-Part Borello Tests
- Attachment C:** Employer Risks Of Misclassifying Employees As Independent Contractors
- Attachment D:** Model Independent Contractor Audit Form
- Attachment E:** Model Independent Contractor Agreement

⁶⁵ It is beyond the scope of this paper to explore the many conflicting decisions arising under state and federal interpretations of the attorney “work product” doctrine or the doctrine as codified in Federal Rule of Civil Procedure 26(b)(3).

ATTACHMENT A

Independent Contractor Models

<p>1. Classic Single Employer Relationship</p>  <p>A worker may contract to be an employee with a corporation (“B” in this example), perform services for “B” which benefit “A” (i.e., a technician may repair A’s photocopier and do so without becoming an employee of “A”).</p>	<p>2. Independent Contractor Relationship</p> <p>a.</p>  <p>b.</p>  <p>A bona fide independent contractor may enter into an agreement to provide services (a) directly to or (b) through a referring agency.</p>	<p>3. Joint Employer Relationship</p>  <p>If a worker is under the direction and control of both the corporation using his or her services and another corporation perhaps even a referring agency), a joint employment relationship can exist whereby both companies “employ” the worker.</p>	<p>4. Alter-Ego/Ally Doctrine/ Single Entity</p>  <p>Corporation “A” (the parent corporation) may find that it is jointly legally responsible for an employee of “B” (a subsidiary) if “A” exerts sufficient “control” over “B.”</p>
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ATTACHMENT B

Comparison of IRS Twenty-Factor Tests To Three-Part Borello Tests

<u>IRS Test</u>	<u>Common Law</u> ⁶⁶	<u>California Labor Code</u> ⁶⁷	<u>Other Courts</u> ⁶⁸
1. whether the individual is required to follow instructions;	1. whether the “employer” has the right to control the manner and means of accomplishing the result;	1. whether the individual has the right of control;	1. the principal’s right of control;
2. amount of training of the individual related to that particular job;	5. whether a high level of skill is required by the occupation;	11. whether a particular skill is required;	4. whether special skill is required;
3. amount of integration of the individual into the employer’s business;	9. whether or not the work is part of the regular business of the employer;	10. performing work which is not in the ordinary course of the principal’s work;	6. whether the services are an integral part of the employer’s business;

⁶⁶ We have distilled these nine “common law rules” from the Supreme Court of California’s decision in S. G. Borello & Sons, Inc. v. Department of Industrial Relations, 48 Cal.3d 341 (1989).

⁶⁷ We have distilled these eleven rules from California Labor Code section 2750.5, which the Borello court cited as helpful to determine independent contractor status. Id. at 2074.

⁶⁸ We have distilled this “six factor [economic realities] test” which courts often apply in wage/hour matters.

ATTACHMENT B

Comparison of IRS Twenty-Factor Tests
To
Three-Part Borello Tests

<u>IRS Test</u>	<u>Common Law</u>	<u>California Labor Code</u>	<u>Other Courts</u>
4. whether services are rendered personally; 5. whether the employer hires, fires and pays assistants; instructions;		2. substantial investment other than personal services; 6. whether the individual hires employees;	3. individual's investment in materials or equipment, or his helpers;
6. existence of a continuing relationship;	7. the length of time the services are provided;		5. the degree of permanence of the working relationship;
7. establishment of set amount of work hours;	1. right of control;	1. right of control;	1. right of control;
8. whether the individual must devote substantially full time to the job;			
9. whether the individual works on the employer's premises;	6. whether the worker provides the supplies, tools and the place of work;	1. right of control;	1. right of control;

ATTACHMENT B

Comparison of IRS Twenty-Factor Tests To Three-Part Borello Tests

<u>IRS Test</u>	<u>Common Law</u>	<u>California Labor Code</u>	<u>Other Courts</u>
10. whether the individual works according to a sequence set by the employer;	4. whether the individual's occupation usually is done without supervision;	1. right of control;	1. right of control;
11. whether the individual must submit regular or written reports to the employer;	1. right of control;	1. right of control	1. right of control;
12. whether the individual is paid by time rather than by project;	8. method of payment, by the job rather than the hour or day;	8. compensation by project rather than by time;	1. right of control;
13. whether the individual is reimbursed for expenses;			
14. whether the individual furnishes the necessary tools and materials;	6. whether the worker provides the supplies, tools and the place of work;	9. whether the individual supplies the tools;	3. individual's investment in materials or equipment, or his employment of helpers;

ATTACHMENT B

Comparison of IRS Twenty-Factor Tests
To
Three-Part Borello Tests

<u>IRS Test</u>	<u>Common Law</u>	<u>California Labor Code</u>	<u>Other Courts</u>
15. whether the individual has invested in the facilities for performing the services;	3. whether the individual's business is a distinct occupation or business;	2. whether the individual has a substantial investment other than personal services	3. individual's investment in materials or equipment, or his employment of helpers;
16. whether the individual can realize a profit or a loss;		4. the individual's opportunity for profit or loss depending on his managerial skills;	2. the individual's opportunity for profit or loss depending on his managerial skills;
17. whether the individual works for more than one firm at a time;			
18. whether the individual makes his/her services available to the general public;	3. whether the individual's business is a distinct occupation or business;	3. whether the individual holds himself out to be in business for himself;	
19. whether the "employer" has the right to discharge the individual; and	2. whether the "employer" has the right to discharge at will, without cause;	7. whether the relationship is severable or terminable at will by the principal or gives rise to an action for breach of controls.	

ATTACHMENT B

Comparison of IRS Twenty-Factor Tests
To
Three-Part Borello Tests

<u>IRS Test</u>	<u>Common Law</u>	<u>California Labor Code</u>	<u>Other Courts</u>
20. whether the individual has the right to terminate the relationship.		7. whether the relationship is severable or terminable at-will by the principal or gives rise to an action for breach of contract.	
	10. whether the parties believe they are creating an independent contractor relationship;	12. the intent of the parties;	
		5. whether the individual holds a license pursuant to the Business and Professions Code;	

ATTACHMENT C

Employer Risks Of Misclassifying Employees As Independent Contractors

<u>Risk</u>	<u>Agency</u>	<u>Legal Test</u>	<u>Possible Penalties</u>
1. State and federal tax liability for failure to withhold payroll taxes on wages; pay social security or unemployment tax, or make State Disability Insurance payments	Internal Revenue Service (“IRS”)	IRS Test	Unpaid taxes Penalty: 5% per month (maximum 25%) penalty for failure to file a payroll tax return (IRC §§ 6651(a)(1)) Interest (IRC §§ 6601)
	California Franchise Tax Board	Common Law Test (Rev. & Taxation Code §§ 18801.5)	Unpaid taxes Penalty = approximately 6% of wages subject to withholding
	California Employment Development Department (“EDD”)	Common Law Test (Unemp. Ins. Code § 621(a))	Unpaid taxes Penalty: 10% of required contribution (Unemployment Insurance Code §§ 1112) Interest (Unemployment Insurance Code §§ 1113)
2. Employer may owe minimum wages/overtime to “contractors”	U.S. Department of Labor (“DOL”)	Economic Realities Test: Right-to-Control is one of six factors	Back wages Liquidated damages \$10,000 Fine, 6 months’ imprisonment
	California Labor Commissioner	<u>Borello</u> implies rejection of Common Law Test	Back wages \$50 Fine, 30 days’ imprisonment

ATTACHMENT C

Employer Risks Of Misclassifying Employees
As Independent Contractors

<u>Risk</u>	<u>Agency</u>	<u>Legal Test</u>	<u>Possible Penalties</u>
3. “Employees” (not independent contractors) may pursue employment discrimination charges	Equal Employment Opportunity Commission	Hybrid Test: Economic Realities Test with Emphasis on Right-to-Control Factors	<ul style="list-style-type: none"> - Back Pay - Front Pay - Equitable Relief - Attorneys’ Fees - Compensatory Damages - Punitive Damages
4. “Employees” (not independent contractors) of federal contractors/subcontractors go into Affirmative Action Plans	Office of Federal Contract Compliance Programs (“OFCCP”)	Hybrid Test: Economic Realities Test with emphasis on Right-to-Control Factors	<ul style="list-style-type: none"> - Debarment
5. “Contractors” who are really “employees” may pursue employment discrimination charges	California Department of Fair Employment and Housing Commission (“DFEH”)	<u>Borello</u> implies rejection of Common Law Test	<ul style="list-style-type: none"> - Back Pay - Front Pay - Compensatory Damages - (Punitive Damages if civil suit)

ATTACHMENT C

Employer Risks Of Misclassifying Employees
As Independent Contractors

<u>Risk</u>	<u>Agency</u>	<u>Legal Test</u>	<u>Possible Penalties</u>
6. Employer may/must treat “employees” as part of the bargaining unit; not “contractors”	National Labor Relations Board (“NLRB”)	Common Law Test with emphasis on Right-to-Control Factors	<ul style="list-style-type: none"> - Reinstatement - Back Pay - Election - Cease-and-Desist Order - Bargaining Order - Litigation - Expenses - Equitable Relief
	California Agricultural Labor Relations Board (“ALRB”)	<u>Borello</u> implies rejection of Common Law Test	<ul style="list-style-type: none"> - Reinstatement - Back Pay - Cease-and-Desist Order - Bargaining Order
7. Employer must complete I-9 immigration forms for “employees” not for “contractors”	Immigration and Naturalization Service (“INS”)	IRS Test	- \$100-\$1,000 fine for each individual violation

ATTACHMENT C

Employer Risks Of Misclassifying Employees As Independent Contractors

<u>Risk</u>	<u>Agency</u>	<u>Legal Test</u>	<u>Possible Penalties</u>
8. Employer may fail to count faux “contractors” as employees when determining coverage under Work Adjustment and Retraining Notification Act (“WARN”); employer will not give nee employees and local government required 60 days’ notice	Private Right of Action	Totality of circumstances	Failure to give notice to individual--up to 60 days’ back pay and benefits; failure to give notice to local government--fines of up to \$500 pr day
9. “Employees” will be eligible for workers’ compensation insurance benefits; contractors not eligible	California Workers’ Compensation Appeals Board	<u>Borello</u> rejected Common Law Test	
10. “Employees” may file wrongful discharge claims; contractors may not	Private Right of Action	Undecided	- Back Pay - Front Pay - Punitive Damages
11. “Employees” may be eligible for pension and employee welfare benefits (such as medical insurance, vacations, sabbaticals and severance pay); contractors not eligible	Private Right of Action	Undecided	- Compensatory - Damages - Punitive Damages - Benefits

ATTACHMENT D

Model Independent Contractor Audit Form

Name of Worker(s) _____

Title of Worker(s) _____ Total number of workers in class _____

Describe the essential elements of the worker's work
.....

This information is about services the worker performed from _____ to _____
(month, day, year) (month, day, year)

Is the worker still performing services for the firm? Yes No

• If "No," what was the date of termination? ► _____
(month, day, year)

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ATTACHMENT D

Model Independent Contractor Audit Form

CONTRACTUAL TERMS

- 1a** Attach a copy if the work is done under a written agreement between the firm and the worker.

- b** If the agreement is not in writing, describe the terms and conditions of the work arrangement.....

- 2a**Does the contract contain a statement the worker is an independent contractor? **Yes** **No**

- b** Does the contract contain a statement to the effect that the contractor has the right to control how the project is to be accomplished? **Yes** **No**

- c** Does the contract contain a provision for payment by the project? **Yes** **No**

- d** Does the contract contain a provision that the contractor supply all tools and equipment if possible? .. **Yes** **No**

- e** Does the contract contain a provision specifying methods, rights and consequences of termination? ... **Yes** **No**

- f** Does the contract contain a statement the worker will pay all out-of-pocket expenses? **Yes** **No**

- g** Does the contract contain a statement the contractor will be responsible for taxes? **Yes** **No**

- h** Does the contract contain a provision requiring the contractor to provide workers' compensation coverage for its employees and any legally required benefits?..... **Yes** **No**

- i** Does the contract contain a provision expressly exempting the contractor from employee benefits? **Yes** **No**

- j** Does the contract posit a cut-off date for the agreement, if the agreement is not project based? **Yes** **No**

- 3** If the actual working arrangement differs in any way from the agreement, explain the differences and why they occur

ATTACHMENT D

Model Independent Contractor Audit Form

DEGREE OF CONTROL

1a Does the service user train the worker? Yes No

- If “Yes,” what kind?
- How often?

b Does the service user instruct the worker in the way the work is to be done (exclusive of actual training)? Yes No

- If “Yes,” give specific examples.....

d Does the firm have the right to change the methods the worker uses or to direct that person on how to do the work?..... Yes No

- Explain your answer

e Does the operation of the firm’s business require the worker to be supervised or controlled in the performance of the service?..... Yes No

- Explain your answer

2a The firm engages the worker:

- To perform and complete a particular job only
- To work at a job for an indefinite period of time
- Other (explain)

ATTACHMENT D

Model Independent Contractor Audit Form

b Does the service user permit the worker to follow a routine or a schedule the firm has established? **Yes** **No**

- If “Yes,” what is the routine or schedule?
-
-

c Does the worker report to the firm or its representative?..... **Yes** **No**

- If “Yes,” how often?
- For what purpose?.....
- In what manner (in person, in writing, by telephone, etc.)?.....

d Does the worker furnish a time record to the firm? **Yes** **No**

3a Approximately how many hours a day does the worker perform services for the firm?

b Does the firm set hours of work for the worker? **Yes** **No**

- If “Yes,” what are the worker’s set hours? _____ a.m./p.m. to _____ a.m./p.m. (Circle whether a.m. or p.m.)

c Is the worker prohibited from competing with the firm either while performing services or during any later period? **Yes** **No**

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ATTACHMENT D

Model Independent Contractor Audit Form

DISTINCT OCCUPATION / BUSINESS

- 1a** Does the worker perform services for the firm under:
- The firm's business name The worker's own business name Other (specify)
- b** Does the worker advertise or maintain a business listing in the telephone directory, a trade journal, etc.?..... **Yes** **No** **Unknown**
- c** Does the worker represent himself or herself to the public as being in business to perform the same or similar services? **Yes** **No** **Unknown**
- If "Yes," how?
- d** Does the worker have his or her own shop or office?..... **Yes** **No** **Unknown**
- If "Yes," where?
- e** Does the firm represent the worker as an employee of the firm to its customers?..... **Yes** **No**
- If "No," how is the worker represented?
- f** How did the firm learn of the worker's services?
- 2** At what location are the services performed? Firm's Worker's Other (specify)
- 3a** Will the worker perform the services personally? **Yes** **No**
- b** Does the worker have helpers? **Yes** **No**
- Whom does the customer pay? Firm Worker
 - If the helpers are hired by the worker, is the firm's approval necessary?..... **Yes** **No**
 - Who pays the helpers? Firm Worker

ATTACHMENT D

Model Independent Contractor Audit Form

- If the worker pays the helpers, does the firm repay the worker? Yes No
- Are social security and Medicare taxes and Federal income tax withheld from the helpers' pay? Yes No
- If "Yes," who reports and pays these taxes? Firm Worker
- Who reports the helpers' earnings to the Internal Revenue Service? Firm Worker
- What services do the helpers perform?

4 Does the worker have a financial investment in a business related to the services performed? Yes No Unknown

5 Can the worker incur a loss in the performance of the service for the firm? Yes No

6 Does the worker assemble or process a product at home or away from the firm's place of business? Yes No

- If "Yes," who furnishes materials or goods used by the worker? Firm Worker Other
- Is the worker furnished a pattern or given instructions to follow in making the product?..... Yes No
- Is the worker required to return the finished product to the firm or to someone the firm designates? Yes No

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ATTACHMENT D

Model Independent Contractor Audit Form

DEVOTION / PERMANENCY

- 1a** Does the worker perform similar services for others? **Yes** **No** **Unknown**
- If “Yes,” are these services performed on a daily basis for other firms? **Yes** **No** **Unknown**
 - If “Yes,” does the firm have first call on the worker’s time and efforts? **Yes** **No**
- b** Percentage of time spent in performing these services for:
- This firm % Other firms % **Unknown**
- c** Percentage of worker’s total income derived from:
- This firm % Other firms % **Unknown**
- 2a** Can the firm discharge the worker at any time without incurring liability? **Yes** **No**
- If “No,” explain
- b** Can the worker terminate the services at any time without incurring a liability? **Yes** **No**
- If “No,” explain

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ATTACHMENT D

Model Independent Contractor Audit Form

LEVEL OF SKILL / EXPERTISE

1 Is a degree necessary for the work? **Yes** **No** **Unknown**

• If “Yes,” what kind of degree is required?.....

2 Is a license necessary for the work? **Yes** **No** **Unknown**

• If “Yes,” what kind of license is required?

• Who issues the license?

• Who pays the license fee?.....

SUPPLIES, TOOLS, AND EXPENSES

1a State the kind and value of tools, equipment, supplies, and materials furnished by:

• The firm

.....

• The worker.....

.....

b What expenses does the worker incur in the performance of services for the firm?.....

.....

c Does the firm reimburse the worker for any expenses? **Yes** **No**

• If “Yes,” specify the reimbursed expenses

ATTACHMENT D

Model Independent Contractor Audit Form

PAYMENT / WITHHOLDINGS

- 1a** Type of pay worker receives:
 Salary Commission Hourly Wage Piecework Lump sum Other (specify).....
- b** Does the firm guarantee a minimum amount of pay to the worker?..... **Yes** **No**
- c** Does the firm allow the worker a drawing account or advances against pay?..... **Yes** **No**
- If “Yes,” is the worker paid such advances on a regular basis?..... **Yes** **No**
- d** How does the worker repay such advances?.....
- 2a** Is the worker eligible for a pension, bonus, paid vacations, sick pay, etc?..... **Yes** **No**
- If “Yes,” specify
- b** Does the firm carry worker’s compensation insurance on the worker?..... **Yes** **No**
- c** Does the firm withhold social security and Medicare taxes from amounts paid the worker?..... **Yes** **No**
- d** Does the firm withhold Federal income tax from amounts paid the worker?..... **Yes** **No**
- e** How does the firm report the worker’s earnings to the Internal Revenue Service?
 Form W-2 Form 1099 Does not report Other (specify).....
- f** Does the firm bond the worker?..... **Yes** **No**

ATTACHMENT D

Model Independent Contractor Audit Form

Answer Only If Worker Is Salesperson Or Provides A Service Directly To Customers.

- 1a** Are leads to prospective customers furnished by the firm? **Yes** **No** **Does not apply**
- b** Is the worker required to pursue or report on leads?..... **Yes** **No** **Does not apply**
- c** Is the worker required to adhere to prices, terms, and conditions of sale established by the firm?..... **Yes** **No**
- d** Are orders submitted to and subject to approval by the firm? **Yes** **No**
- e** Is the worker expected to attend sales meetings?..... **Yes** **No**
- If “Yes,” is the worker subject to any kind of penalty for failing to attend? **Yes** **No**
- f** Does the firm assign a specific territory to the worker?..... **Yes** **No**
- g** Whom does the customer pay? **Firm** **Worker**
- If worker, does the worker remit the total amount to the firm? **Yes** **No**
- h** Did the firm or another person assign the route or territory and a list of customers to the worker?..... **Yes** **No**
- i** Did the worker pay the firm or person for the privilege of serving customers on the route or in the territory? **Yes** **No**
- j** How are new customers obtained by the worker? Explain fully, showing whether the new customers called the firm for service, were solicited by the worker, or both.....
- k** Is the worker a traveling or city salesperson? **Yes** **No**
- If “Yes,” from whom does the worker principally solicit orders for the firm?
 - If the worker solicits orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments, specify the percentage of the worker’s time spent in the solicitation %

ATTACHMENT E

Model Independent Contractor Agreement

This Agreement is made as of _____, 200____, by and between _____ (“the Company”), and _____ (“Contractor”) (collectively “the parties”).

The parties agree as follows:

A. **BASIC SERVICES:** Subject to the terms and conditions of this Agreement, and on a non-exclusive basis, Contractor agrees to provide the following services to the Company (the “Services”): _____

B. **TERM:** Contractor will commence performance of the Services on or about the date first set forth above, and shall continue until completion of the Services unless earlier terminated as set forth in Section G below.

C. **FEES AND EXPENSES:** In consideration of the Services, the Company agrees to pay Contractor in accordance with the following rates: _____

Contractor shall be responsible for all expenses necessary to carry out the Services, and shall not be reimbursed by the Company for such expenses, except as follows: _____

Contractor shall invoice the Company for Services performed based upon such rates on a [weekly/monthly/other] basis. Payment on invoices shall be due _____ (__) days after receipt. The expenses referred to in Section C will be reimbursable only in the actual amounts incurred by Contractor, with no markups or add-ons of any kind. Contractor shall invoice the Company [monthly/weekly/other] in arrears for such expenses and shall provide appropriate vouchers and receipts to support such reimbursement.

D. **OWNERSHIP:** [Note: The Company should consider a broader assignment provision as part of a separate Non-Employee Invention Assignment and Confidentiality Agreement including a Power of Attorney clause in case the independent contractor is either a recalcitrant author or inventor who refuses to assign his/her rights, in fact, or dies. If the parties use such an Agreement, the user

ATTACHMENT E

Model Independent Contractor Agreement

of this form should delete this paragraph to avoid conflict.] The parties agree that all Services and any elements thereof, created, performed, contributed or prepared by Contractor pursuant to the Agreement, and any results or proceeds thereof, shall be the exclusive property of the Company. Without reservation, limitation or condition, Contractor hereby assigns, transfers and conveys to the Company, exclusively and perpetually, all right, title and interest throughout the world which Contractor has or may be deemed to have in the Services and any elements thereof, including without limitation all copyrights, patents, rights of reproduction, and rights to ownership of any physical works of art embodied therein, and the right to secure registrations, renewals, reissues and extensions thereof. Contractor agrees to execute such further documents and to do such further acts as may be reasonably necessary to perfect, register or enforce the Company's ownership of any such rights. Contractor hereby appoints the Company as Contractor's attorney-in-fact (this appointment being irrevocable and coupled with an interest) to execute such documents on Contractor's behalf.

Contractor warrants and represents that to the best of Contractor's knowledge, the Services and any elements thereof, including without limitation any materials provided to the Company, are original creations of Contractor and do not violate any copyright, proprietary rights or other rights of any person or entity and that no third party has any rights, title or interest therein or thereto.

- E. **INDEMNITY AND WARRANTY:** Contractor agrees to indemnify and hold the Company harmless from and against any and all claims, demands, causes of action, losses, damages, liabilities, costs, and expenses, including attorneys' fees, arising from a breach of any of Contractor's representations and warranties herein or from the death or injury of any person or persons, including employees of the Company, or from the damage or destruction of any work or properties, attributable to or resulting from Contractor's performance of the Services. Contractor warrants and represents that Contractor has full power and authority to enter into and perform this Agreement and to make the grant of rights contained herein.
- F. **CONFIDENTIALITY:** [**Note: The Company should consider a broader confidentiality provision as part of a separate non-Employee Invention Assignment and Confidentiality Agreement. If the parties use such an Agreement, the user of this form should delete this paragraph to avoid conflict.**] Contractor acknowledges and agrees: (a) that all work provided pursuant to this Agreement, and any documents or materials related to the Services, and any information, work in progress, trade secrets, or other secret or confidential matter related to the business or projects of Company, constitute confidential information (hereinafter "Confidential Information"); (b) that Contractor shall not, either during the rendering of services or at any time thereafter, use, copy, or disclose to any person, firm, or corporation any such Confidential Information, unless such use, copying, or disclosure has been authorized in advance in writing by the Company; and (c) that upon termination or expiration of this Agreement, or at any time upon request of the Company, Contractor will return to the Company all Confidential Information in Contractor's possession or control.

ATTACHMENT E

Model Independent Contractor Agreement

G. TERMINATION:

- (a) Termination for Default. In the event of any material breach of this Agreement by either party hereto, the other party may (without waiving any other remedies or rights under this Agreement, in law or in equity) terminate this Agreement by giving ten (10) days prior written notice; provided, however, that this Agreement shall not terminate if the party in breach has cured the breach of which it has been notified prior to the expiration of said ten (10) days. **[Note: The parties may consider removing the term “material” from the first sentence. This will render the default provision more flexible and easier – for both parties - to satisfy.]**
- (b) Termination by the Company. Notwithstanding any other provision of this Agreement to the contrary, the Company may terminate this Agreement if Contractor’s performance is unsatisfactory in the Company’s judgment by giving Contractor at least five (5) days prior written notice of its election to terminate said Agreement. In case of any termination, the Company agrees to:
 - (i) Pay Contractor for all costs incurred by Contractor in connection with the Services up to the effective date of termination at the agreed upon rates and expenses set forth herein; OR
 - (ii) Pay nothing to Contractor if the Contractor’s services fail to produce at least the following usable goods or services: _____
- (c) Automatic Termination. This Agreement shall automatically terminate on the occurrence of:
 - (i) The dissolution, bankruptcy or insolvency of either party; or (if applicable)
 - (ii) The death of Contractor.
- (d) Effect of Termination: Sections D, E, F, I, J, L and M shall survive the expiration or termination of this Agreement. **[Note: This section should be modified if a separate Confidentiality/Inventions Agreement is implemented.]**

H. ASSIGNMENT: Neither this Agreement nor any rights or duties hereunder may be assigned or delegated to any other person or entity by Contractor except as specifically provided hereunder, without the express prior written consent of the Company. The Company may freely assign this Agreement and/or any of its rights hereunder.

I. AUTHORITY/RELATIONSHIP OF PARTIES: The parties intend, and Contractor acknowledges, that contractor will perform all Services hereunder as an independent contractor and not as an employee of the Company. Contractor will be solely responsible for, and the Company shall not provide or be liable for, typical employee benefits (including but not limited to, health and disability insurance, vacation and/or paid time

ATTACHMENT E

Model Independent Contractor Agreement

off, etc.). The Company shall not be responsible to withhold from Contractor's payments nor remit to the tax authorities any payroll or other tax, social security or Medicare contribution, or any other tax or contribution. Contractor agrees to pay, as and when due, any and all taxes assessed or incurred in connection with Contractor's compensation hereunder, including estimated taxes, and will provide the Company with documentation of such payment upon request. Contractor further agrees to indemnify and hold the Company harmless from and against liability for any and all such payments. Nevertheless, Contractor agrees that the Company may withhold from payment to Contractor any amounts which the Company determines it is required to withhold by applicable law. Contractor will remain free to perform services for parties other than the Company; provided, that such services will not conflict or interfere with the performance of Services hereunder, and will not compete with the current or future business of the Company. Contractor further agrees and acknowledges that: (a) Contractor's relationship with the Company is not an employment relationship; (b) Contractor is solely responsible for determining the method and means by which Contractor will accomplish the Services and otherwise fulfill Contractor's obligations hereunder; and (c) Contractor will be solely responsible for the professional performance of the Services, and will receive no training, assistance, direction or control from the Company except as specifically set forth in this Agreement. Contractor shall be solely responsible for obtaining, at Contractor's expense and in Contractor's name, disability, worker's compensation or other insurance as well as all licenses and permits usual or necessary for conducting the Services hereunder. Contractor represents that Contractor has the qualifications, skills, and ability to perform the Services in a professional manner, without the advice, control or supervision of the Company. Nothing contained in this Agreement shall be construed to place the parties in the relationship of partners or joint venturers and neither party shall have any right to obligate or bind the other in any manner. Contractor agrees that it will not hold itself out as an authorized agent with power to bind the Company in any manner.

- J. **GOVERNING LAW:** This Agreement will be governed by and construed in accordance with the laws of the State of California. Any litigation or other dispute with respect to this Agreement will take place in _____ County, California. The parties agree that venue is proper in the state and federal courts within or having jurisdiction over such county.
- K. **AMENDMENTS:** This Agreement may be amended only in writing signed by both parties. Failure by either party to enforce at any time any of the provisions of this Agreement, or to require at any time performance by the other party of any of the provisions hereof, shall in no way be construed as a waiver of such provisions in any other circumstance or a waiver of any other provision.
- L. **SEVERABILITY:** In the event any one or more of the provisions of this Agreement shall for any reason be held to be invalid, illegal or unenforceable, then the invalid, illegal or unenforceable provision shall be stricken, and the remainder of the Agreement fully enforced.

ATTACHMENT E

Model Independent Contractor Agreement

- M. **ADVERTISING OR PUBLICITY:** Contractor will acquire no right to use, and will not use without the Company's prior written consent, the names, characters, artwork, designs, tradenames, copyrighted materials, trademarks or service marks of the Company, its parent, related or subsidiary companies, employees, directors, shareholders, assigns, successors or licensees: (a) in any advertising, publicity or promotion; (b) to express or to imply any endorsement of Contractor's services; or (c) in any manner other than in accordance with this Agreement.

- N. **COMPLETE AGREEMENT.** This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior or contemporaneous agreements or understandings, whether written or oral, between the parties with respect thereto.

O. **ADDITIONAL TERMS (IF ANY):**

[COMPANY NAME]

CONTRACTOR

By: _____

By: _____

Name: _____

Name: _____

Date: _____

Date: _____

Title: _____

Title: _____