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MITIGATING RISKS TO MAXIMIZE THE ADVANTAGES OF YOUR CONTINGENT WORKFORCE

By Tritia M. Murata

INTRODUCTION

The "traditional" workplace as we once knew it is changing, and a key component of this evolution is the rise of the contingent workforce. Companies are continuously seeking innovative ways to cut costs, increase efficiency, and perform competitively, and the strategic use of contingent workers can be an effective tool in advancing these goals. Across the board, companies are increasing their use of contingent workers, which

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can include independent contractors, temporary workers, consultants, and interns. Indeed, according to a research study published by Oxford Economics, a whopping 83 percent of American companies say they are increasingly using contingent, intermittent, seasonal, or consultant workers.[1] The changing nature of the workforce is forcing companies to learn to manage their workers in new and different ways. There are also risks associated with the use of contingent workers, including significant potential liability for worker misclassification. It is critical for companies to be aware of those risks, and knowledgeable about how to navigate them.

THE BENEFITS OF USING CONTINGENT WORKERS

There are myriad motivations driving companies' increased use of contingent workers. The most obvious benefit, of course, is that effective and appropriate use of contingent workers can provide significant cost savings—including employment tax savings, savings on unemployment and workers' compensation insurance, administrative savings, and savings on employee benefits (which are typically not provided to contingent workers). Using contingent workers also gives companies flexibility to better match the flow of work to the amounts they pay for that work, by using fewer contingent workers during periods of downtime. Ironically, these cost savings can provide additional job security to a company's permanent workforce.

Another benefit of using contingent workers is that with the increasing pool of highly skilled contractors and consultants, using contingent workers can allow companies to better match worker expertise with their specific, ever-changing business needs. Indeed, in recent years, there has been a meteoric rise in high-level executives and professionals leaving their permanent positions to become independent workers—and they are well compensated for the expertise they bring to the table.[2] Benefits to workers can include the increased autonomy and flexibility of being an independent contractor or consultant, as well as the interesting, challenging, and dynamic work that project-based assignments can offer. In addition, for workers who are interested, excelling in a contingent position can sometimes lead to permanent employment.

POTENTIAL PITFALLS

Notwithstanding the significant benefits, the potential risks of using contingent workers cannot be overstated. The most significant potential risk in a contingent worker relationship is the potential liability associated with worker misclassification, which we discuss in detail below. Another important risk companies must manage is protecting their confidential, proprietary, and trade secret information. With contingent workers who perform work for a company before—or even while—doing work for someone else, it is especially important to take appropriate steps to ensure that any company information they may access is adequately protected. Using international contingent workers creates additional issues and risks involving international laws, immigration laws, tax laws and others.

Additionally, there are intangible drawbacks to using contingent workers, such as impacts on morale if permanent workers perceive that they are missing out on opportunities for interesting work or overtime due to the contingent workforce. Contingent workers can also feel disconnected from the traditional workforce and less personally invested in the company and its long-term goals.

MISCLASSIFICATION

Misclassifying workers as independent contractors or (unpaid) interns instead of employees—even if unintentional—can subject a company to enormous liability, including back taxes, penalties, and litigation costs and damages, among others. Independent contractor misclassification has been an area of particular focus for the Internal Revenue Service (IRS) and the Department of Labor (DOL) in recent years.[3] Indeed, in 2011, as part of the DOL's "Misclassification Initiative," the agencies joined forces to combat worker misclassification.[4] California recently enacted legislation authorizing the Labor and Workforce Development Agency (LWDA) or a state court to impose civil penalties ranging from $5,000 to $25,000 per violation for an employer's willful misclassification of independent contractors.[5]

Misclassification is also an increasingly active area for lawsuits filed by contingent workers, including putative class actions seeking employee benefits

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(such as the *Vizcaino v. Microsoft* "permatemp" case that resulted in a $97 million settlement) and damages for alleged wage and hour violations. Allegations of misclassification and joint employment can also arise in discrimination and other employment actions, where a contingent worker may attempt to invoke the protections of employment statutes that traditionally apply to employees but generally not to independent contractors, or in cases filed by third parties claiming tort liability.[6] Recently—particularly in New York—there has been a wave of lawsuits challenging unpaid internship programs. Several of these cases have resulted in settlements in the millions.

THE APPLICABLE STANDARDS: INDEPENDENT CONTRACTOR OR EMPLOYEE?

One frustrating challenge for companies that are just trying to get it right is that different courts and different government agencies have adopted different tests for determining worker status. The result is that a worker could be an employee under one test and a bona fide independent contractor under another. A common thread at the core of all of the tests, however, is the company's right to control the manner and means of accomplishing a particular result. If the company has the *right* to control the details of how the work is accomplished, rather than simply specify the desired end product, the worker is generally considered to be an employee. Bear in mind that the right to control is what matters, irrespective of whether the company actually exerts control as a practical matter. We briefly describe the principal tests below.

The Federal Common Law *(Darden)* Test

The federal common law test—typically used in ADA, ADEA, Title VII, and ERISA actions—is set forth in the U.S. Supreme Court's decision in *Nationwide Mut. Ins. Co. v. Darden*.[7] Under the *Darden* test,

Equal Employment Opportunity Commission *(EEOC) v. Ford Motor Co.*: Telecommuting Is Not Necessarily a Reasonable Accommodation

On April 10, the Sixth Circuit issued a divided en banc decision holding 8-5 that Ford did not fail to reasonably accommodate resale buyer Jane Harris when it refused to allow her to telecommute on an as-needed basis, up to four days per week, as an accommodation for her irritable bowel syndrome.[17] We have twice reported on this interesting case filed by the EEOC on Harris' behalf—first when the district court granted summary judgment to Ford,[18] and again when the Sixth Circuit reversed, in a controversial 2-1 decision.[19] This decision endorses the common sense notion that regular and predictable onsite job attendance is an essential function—and a prerequisite to essential functions—of most jobs, particularly interactive jobs. Notwithstanding, employers should not view this case as a free pass to deny telecommuting requests in all circumstances.

Factual background. Harris worked for Ford from April 2003 through September 2009 as a resale buyer of steel, a highly interactive position requiring meetings with suppliers and employees and parts manufacturers—meetings that, in Ford's business judgment, were most effectively performed face to face. At first, Harris' performance was adequate, but over time, her work deteriorated significantly. In addition, she had chronic attendance problems. In 2008, she missed an average of 1.5 work days per week, and in 2009, she was absent from work more often than present. Additionally, she often came in late and left early. Harris' colleagues were forced to compensate for her, causing them stress and frustration.

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in determining whether a worker is an employee under the general common law of agency, a court will consider the company's right to control the manner and means by which the product is accomplished. The following factors are relevant to this inquiry:

- The skill required;
- The source of the instrumentalities and tools;
- The location of the work;
- The duration of the relationship between the parties;
- Whether the company has the right to assign additional projects to the worker;
- The extent of the worker's discretion over when and how long to work;
- The method of payment;
- The worker's role in hiring and paying assistants;
- Whether the work is part of the regular business of the company;
- Whether the company is in business;
- The provision of employee benefits; and
- The tax treatment of the worker.

The Economic Realities (FLSA) Test

The economic realities test, used to evaluate independent contractor status under the Fair Labor Standards Act (FLSA), focuses on the economic relationship between the company and the worker, and whether the worker is economically dependent on the company.[8] Some jurisdictions will apply the economic realities test, or a hybrid of the economic realities test and the *Darden* test, in other contexts outside of the FLSA. Factors generally considered include:

- To what extent is the work performed an integral part of the company's business?
- Do the worker's managerial skills

Harris' irritable bowel syndrome contributed to her performance and attendance issues. Ford attempted three different telecommuting and flexible schedules to try to help Harris improve her performance and establish regular and predictable attendance. None of them worked. Following these three failed attempts, Harris asked for permission to work up to four days per week from home. Ford considered the request, met with Harris to discuss it, and determined it to be unreasonable. Other resale buyers were permitted to telecommute at most one day per week and were required to come to the worksite even on telecommuting days as needed. Even Harris conceded that, of her 10 key job responsibilities, she could not perform four of them from home. Ford offered to accommodate Harris in other ways. She refused.

After being placed on a Performance Enhancement Plan and failing to meet its requirements, Harris' employment was terminated. Almost two years later, the EEOC sued Ford on her behalf, alleging failure to accommodate her disability and retaliation for filing a charge with the EEOC.

Procedural background. The district court granted summary judgment in Ford's favor, holding that telecommuting up to four days per week is not a reasonable accommodation under the ADA, and Harris could not overcome Ford's legitimate, non-retaliatory reason for terminating her employment: her poor performance. The EEOC appealed, and the Sixth Circuit, in a sharply divided decision, reversed. The Sixth Circuit granted en banc review.

The en banc majority opinion. The Sixth Circuit's en banc majority opinion affirmed the district court's summary judgment grant in Ford's favor, holding that regular and predictable job attendance is an essential function of most jobs, including Harris'. The decision's opening sentence emphasizes that the ADA "requires employers to reasonably accommodate their disabled employees; it does not endow all disabled persons with a job—or job schedule—of their choosing." The court rejected the argument that permitting limited telecommuting one day

impact his or her opportunity for profit and loss?

- What are the relative investments in facilities and equipment by the worker and the company?
- What is the degree of the worker's skill and initiative?
- What is the degree of permanency of the worker's relationship with the company?
- What are the nature and degree of control the company exercises over the worker?

What doesn't matter to the DOL? The DOL specifically states that the fact that the worker has a signed independent contractor agreement is not controlling. Additionally, the fact that the worker has incorporated a business or is licensed by a state or local government agency matters little to the DOL. The time and mode of payment also has little relevance.[9]

The Internal Revenue Service Test

The IRS has developed its own standard for evaluating whether a worker is an employee for federal tax purposes. Previously, the IRS applied a 20-factor test to determine whether a worker was an employee or an independent contractor. More recently, the IRS has reframed the analysis into three categories, which largely incorporate the 20 factors: behavioral control, financial control, and type of relationship.[10] The focus of the IRS analysis is on whether the company has the right to control the manner and means of accomplishing the work to be done.

Behavioral control: Does the company control or have the right to control what the worker does and how the worker does his or her job?[11] Relevant inquiries include:

- **Types of instructions the company gives the worker.** Is the worker subject to the company's instructions about when, where, and how to work?

per week in limited and predictable circumstances created a factual dispute regarding whether it was reasonable to allow Harris to telecommute on an unpredictable basis for up to four days per week. And it credited Ford's business judgment, which was supported by substantial evidence, that in-person attendance was necessary to Harris' job. The court further held that Ford did not retaliate against Harris for filing a discrimination charge with the EEOC.

The dissent. Five Circuit judges dissented to the majority opinion in Ford's favor, on the ground that the evidence before the district court created disputed facts that precluded a summary judgment award for Ford.

Takeaways. The Sixth Circuit's en banc majority opinion does not mean telecommuting can never be a reasonable accommodation. To the contrary, what is reasonable is a case-by-case inquiry that will depend on the circumstances. The nature of the position and the extent to which you permit other employees to telecommute will be considered, as well as any applicable telecommuting policy. Your business judgment regarding whether in-person attendance is an essential function of the job will be afforded consideration, but it will not be dispositive.

It remains to be seen whether the EEOC will petition for Supreme Court review, and if so, whether certiorari will be granted. Given the high profile of the case, the significance of the issue, and the vigorous division of the original Sixth Circuit panel and the en banc panel, this case may well be a good candidate for Supreme Court review.

For example, does the company dictate:

- When and where to do the work?
- What tools or equipment to use?
- What workers to hire or to assist with the work?
- Where to purchase supplies and services?
- What work must be performed by a specified individual?
- What order or sequence to follow when performing the work?

This inquiry is a case-by-case assessment. Even if no instructions are given, the behavioral control component of the IRS test can weigh in favor of finding that the worker is an employee if the business has the right to control the details of a worker's performance, or how the work results are achieved.

Degree of instruction. How detailed are the instructions the company gives the worker? The more detailed the instructions, the more likely the worker is an employee and not an independent contractor.

- **Evaluation system.** Does the company have an evaluation system for measuring the worker's performance? If workers are evaluated based on the details of how the work is performed, they are more likely to be employees.
- **Training.** While an employer can train its employees to perform their work in a particular manner, independent contractors will ordinarily use their own methods to accomplish their work.

Financial control: Does the company have the right to control the economic aspects of the worker's job?[12] The following considerations are relevant, but none on its own is dispositive.

- **Significant investment.** Independent contractors will often have a significant investment in the facilities or equipment they use to perform their work.
- **Unreimbursed expenses.** Independent contractors are more likely than employees to have unreimbursed expenses.
- **Opportunity for profit or loss.** Independent contractors will often have the opportunity to make a profit or be exposed to the risk of incurring a loss as a result of their work.
- **Services available to market.** Independent contractors should generally be free to seek out other business opportunities.
- **Method of payment.** Independent contractors are generally paid a flat fee for the job. Employees are typically guaranteed a regular wage, either in terms of an hourly rate or a salary paid in regular increments.

The nature of the relationship between the parties: How do the company and the worker characterize their relationship?[13]

- **Written contracts.** Is there a written agreement stating that the worker is an independent contractor? Even if there is, the presence of such an agreement is not determinative.
- **Employee benefits.** Does the company provide the worker with employee benefits (such as insurance, pension plans, paid vacation, sick days, and disability insurance)?
- **Permanency of the relationship.** If the relationship between the company and the worker is of indefinite duration, rather than for a specific project or period, this factor weighs in favor of finding the worker is an employee.
- **Services provided as key activity of the business.** If a worker provides services that are a key aspect of the company's regular business activity, it is more likely that the company will have retained the right to control and direct the worker's activities.

State-Specific Tests

In addition to the various federal tests for determining worker status, states have implemented their own standards. For example, in California, the common law test for distinguishing employees from independent contractors is set forth in *S.G. Borello & Sons, Inc. v. Dep't of Indus. Relations*.[14] Under *Borello*, "[t]he principal test of an employment relationship is whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired." Secondary factors considered include:

- The right to discharge at will, without cause;
- Whether the worker is engaged in a distinct occupation or business;

- The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
- The skill required in the particular occupation;
- Whether the company or the worker supplies the instrumentalities, tools, and the place of work for the worker;
- The length of time for which the services are to be performed;
- The method of payment, whether by the time or by the job;
- Whether or not the work is a part of the regular business of the company; and
- Whether or not the parties believe they are creating the relationship of employer-employee.

The California Employment Development Department (EDD)—the agency responsible for state programs involving unemployment insurance, disability insurance, payroll tax collection, job training, and workforce services—has issued its Employment Determination Guide to help businesses determine worker status.[15] The EDD's Guide contains a worksheet that asks the following questions and provides guidance on how to interpret the answers:

- Does the company instruct or supervise the worker while he or she is working?
- Can the worker be discharged at will?
- Is the worker performing work that is a regular part of the company's business?
- Does the worker have a separately established business?
- Is the worker free to make business decisions that impact his or her ability to profit from the work?
- Does the individual have a substantial investment that would subject him or her to a financial risk of loss?
- Does the company have employees who do the same type of work?
- Does the company furnish the tools, equipment, or supplies used to perform the work?
- Is the work considered unskilled or semiskilled labor?
- Does the company provide training for the worker?
- Is the worker paid a fixed salary, an hourly wage, or based on a piece-rate basis?
- Did the worker previously perform the same or similar services for you as an employee?
- Does the worker believe that he or she is an employee?

At least one appellate court decision, now depublished and pending review before the California Supreme Court, has held that for wage and hour claims covered by an Industrial Welfare Commission Wage Order, the test for employee status is the extremely broad definition of employment set forth in the Wage Orders.[16]

PRACTICAL GUIDANCE

Despite the risks, the use of contingent workers can be tremendously beneficial, provided they are properly classified. The following suggestions will help your company manage and minimize risk, and get the most out of your contingent worker arrangements.

Review the language in your contingent worker agreements. Ensure that the contract language does not include provisions that give your company the right to control the manner and means by which your workers accomplish the desired result. Consider including an express provision that your company does not have any right to control the manner and means of accomplishing the work to be done. Consider not using identical agreements for every contractor, but instead drafting language that reflects the unique situations of each worker. When contracting with outside organizations to provide workers to your company, make sure your contracts are clear and protective of your company's interests. For example, you should ensure there is an appropriate indemnification provision that adequately protects your company in the event misclassification is alleged.

Assess the classification of your workers. When possible, have outside counsel skilled in the area of worker-classification issues conduct the assessment. If the results of the assessment suggest it is appropriate to do so, you may determine

you need to reclassify certain of your workers as employees. You should seek guidance from outside counsel when doing so, in order to minimize the risks that the reclassification will trigger allegations of misclassification.

In appropriate circumstances, you can seek advisory guidance regarding your classification of contingent workers. For example, you can file an IRS form SS-8 to get an official determination of a worker's status. If you are in California, you can seek a Determination of Employment Work Status (DE 1870) with the EDD or an advisory opinion from the Division of Labor Standards Enforcement (DLSE). One benefit of seeking an advisory opinion from the DLSE—assuming you receive a response—is that this can be done anonymously, through outside counsel. You should seek guidance from counsel before seeking guidance directly from any government agency, as there are risks involved and you must be prepared to live with the determination you receive.

Educate your employees. Educate and train company employees who work with your contingent workers, so they understand what the roles of the company's contingent workers are supposed to be, and so they know of the potential pitfalls of treating contingent workers as though they are regular employees. Educate and advise the employees who make classification decisions, so they understand the factors that will be considered if their classification decisions are ever challenged.

Be consistent. Where practicable, evaluate new workers whom your company would like to bring on as contingent workers on a case-by-case basis. Develop strategic, integrated practices and procedures for your workforce so that your company is consistent in its decisions about who is an employee and who is a bona fide contingent worker.

Protect proprietary information. Take steps to secure and protect your confidential and trade secret information. You should approach this from two directions. First, you should take steps to implement appropriate physical and data security to protect your proprietary, confidential, and trade secret information. As with all workers, whether contingent workers or employees, you should limit access to your company's crown jewels and ensure that only individuals who need access are afforded it. Second, you can and should ensure that you have contractual protections in place, through which your contingent workers agree not to misappropriate company information.

CONCLUSION

As companies' use of contingent workers increases, so too do the risks associated with that use. In order to ensure that your contingent workforce is truly providing a benefit to your organization, it is more important than ever to ensure that your organization understands the issues and the risks, and takes appropriate steps to address them.

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To view prior issues of the ELC, click here.

1 See Oxford Economics, *Workforce 2020: The Looming Talent Crisis*, at 4-5 (Sept. 5, 2014).

2 See Jody Greenstone Miller & Matt Miller, *The Rise of the Supertemp: The Best Executive and Professional Jobs May No Longer Be Full-Time Gigs*, Harvard Business Review, May 2012.

3 See Employment Law Commentary, *How to Deal with Worker Classification Tax Audits*, Apr. 2010.

4 See Employment Law Commentary, *Employee or Independent Contractor: It's Time to Assess*, Mar. 2010.

5 Cal. Lab. Code § 226.8(b), (c).

6 See Employment Law Commentary, *Independent Contractors: Recent Developments in the Courts*, Nov. 2011.

7 503 U.S. 318, 323-24 (1992).

8 *See* DOL Fact Sheet #13: "Am I an Employee?: Employment Relationship Under the Fair Labor Standards Act (FLSA)," available at http://www.dol.gov/whd/regs/compliance/whdfs13.pdf; *Real v. Driscoll Strawberry Assocs., Inc.*, 603 F.2d 748, 754-55 (9th Cir. 1979).

9 *See supra* note 8.

10 See IRS Publication 15-A at 7-8 (2015), available at http://www.irs.gov/pub/irs-pdf/p15a.pdf.

11 IRS Publication 15-A at 7 (2015); *see also* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Behavioral-Control.

12 IRS Publication 15-A at 7-8 (2015); *see also* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Financial-Control.

13 IRS Publication 15-A at 8 (2015); *see also* http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Type-of-Relationship.

14 48 Cal. 3d 341 (1989).

15 EDD Employment Determination Guide (DE 38 Rev. 3 (9-14)), available at http://www.edd.ca.gov/pdf_pub_ctr/de38.pdf.

16 *Dynamex Operations West, Inc. v. Super. Ct.*, 341 P.3d 438 (Cal. 2015), granting review of *Dynamex Operations West, Inc. v. Super. Ct.*, 230 Cal. App. 4th 718 (2014). The issue presented in *Dynamex* is whether, "[i]n a wage and hour class action involving claims that the plaintiffs were misclassified as independent contractors," a class may "be certified based on the Industrial Welfare Commission definition of employee as construed in *Martinez v. Combs* (2010) 49 Cal.4th 35, or should the common law test for distinguishing between employees and independent contractors discussed in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989) 48 Cal.3d 341 control?" *Martinez* interpreted the wage order's definitions of "employee" and "employer" to find that produce merchants were not joint employers of the farm laborers who worked for a strawberry farmer from whom the merchants bought strawberries. The *Martinez* court expressly disclaimed that it was deciding whether *Borello* had any relevance to wage claims. (*Martinez*, 49 Cal. 4th at 73.) According to *Martinez*, "under the IWC's definition," the term "employ" "has three alternative definitions. It means: (a) to exercise control over the wages, hours or working conditions, or (b) to suffer or permit to work, or (c) to engage, thereby creating a common law employment relationship." (*Id.* at 64.) The produce merchants were not the farm laborers' employers under any of these definitions.

17 *EEOC v. Ford Motor Co.*, No. 12-2484, 2015 U.S. App. LEXIS 5813 (6th Cir. Apr. 10, 2015).

18 *EEOC v. Ford Motor Co.*, No. 11-13742, 2012 U.S. Dist. LEXIS 128220 (E.D. Mich. Sept. 10, 2012).

19 *EEOC v. Ford Motor Co.*, 752 F.3d 634 (6th Cir. 2014).

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