Litigation Issues Involving Staffing Agencies and PEOs: We're in This Together . . . Or Are We?

ABA Section of Labor and Employment Law,
Employment Rights and Responsibilities Committee Midwinter Meeting
Clearwater, Florida

March 23, 2018

Michael P. Royal
Devjani H. Mishra
Littler Mendelson, P.C

Litigation Issues Involving Staffing Agencies and PEOs: We're in This Together . . . Or Are We?

I. INTRODUCTION

A company's legal obligation to its workers under federal and state employment and labor laws takes on added complexity when the company utilizes contingent labor. The term "contingent labor" broadly refers to all workforce relationships, with the exception of full-time employment, including:

- W-2 employees of a staffing firm, outsourcing company or other vendor;
- independent contractors and consultants;
- direct part-time employees; and
- direct employees leased back by leasing companies, professional employer organizations, and similar secondment agreements between two related or unrelated companies.

This paper focuses on the potential legal risks associated with the last category, which often includes third-party staffing, *e.g.*, where staffing firms recruit, hire and employ the workers; outsourcing companies that totally manage a specific business function for their clients, often on the business premises of their clients; professional employer organizations (PEOs) which provide administrative support to workers recruited and supervised by their client-companies; and leasing firms that provide a hybrid of administrative services to a company. For convenience, third-party staffing companies, leasing companies and professional employer organizations may generally be referred to as a "Third-Party Firm" or "Staffing Agency" and the entity that the Third-Party Firm provides contingent workers to may generally be referred to as the "Client Company" or "Client Employer." However, prior to discussing the potential litigation risks related to the use of Third-Party Firms, a brief discussion of the background and characteristics of such business entities is warranted.

II. TYPES OF THIRD-PARTY FIRMS

Employee leasing firms and professional employer organizations (PEOs) are firms that contract with companies to become the "employer of record" and offer related employment benefits to the workers of their client-companies. The relationship is memorialized in a formal contract and the entities become contractual co-employers with very specific contractual rights and responsibilities owed to the workers and between the two entities. As described by the National Association of Professional Employer Organizations (NAPEO), a "leasing or staffing firm" supplies (recruits, screens

and hires) new workers to a client company, while a "PEO" supplies administrative services to a client company and its existing workforce (as opposed to supplying labor for the client).[1] Accordingly, a PEO will serve as the "employer of record" and administer payroll and tax obligations, but they do not recruit, screen, hire, supervise or terminate the workers. However, the workers receive a direct W-2 from the PEO and are generally able to participate in the benefits plans of the PEO.

Temporary staffing firms and referral agencies are other types of Third-Party Firms. The DOL notes that temporary staffing firms place temporary workers (also referred to as "agency temporaries") at a "client's worksite, and typically, though not always, the assignment is for a short period of time (less than a year)." [2] To add to the complexity, temporary staffing agencies may also often lease workers to the client. The NAPEO adds that a temporary staffing firm recruits, screens, hires and assigns its employees to clients to support or supplement the client's workforce. Finally, a referral agency simply refers workers to client companies and treats the workers as independent contractors with respect to itself.[3]

There are four possible arrangements when a Third-Party Firm is interposed between a worker and a Client Company:

- the worker is an employee of both the Third-Party Firm and the Client Company;

- the worker is an employee of the Third-Party Firm and a nonemployee (sometimes an

  independent contractor) of the Client Company;

- the worker is a nonemployee (or independent contractor) of the Third-Party Firm and an employee of the Client Company; or

- the worker is a nonemployee (or independent contractor) of both the Third-Party Firm and the Client Company.

Apart from the foregoing, when a Third-Party Firm is involved, a worker's status may be characterized differently for purposes of different laws. For example, a worker may qualify as a non-employee or independent contractor of both the Third-Party Firm and the Client Company for federal employment tax purposes, but qualify as a non-

[1] *See* National Association of Professional Employer Organizations (NAPEO), *What is a PEO? Frequently Asked Questions*, available at http://napeo.org/what-is-a-peo/selecting-a-peo/faqs.

[2] Susan N. Houseman, DOL, *Flexible Staffing Arrangements: A Report on Temporary Help, On-Call, Direct-Hire Temporary, Leased, Contract Company, and Independent Contractor Employment in the United States* (Aug. 1999).

[3] *See* National Association of Professional Employer Organizations (NAPEO), *What is a PEO? Frequently Asked Questions*, available at http://napeo.org/what-is-a-peo/selecting-a-peo/faqs.

employee or independent contractor of the Third-Party Firm and an employee of the Client Company for employee benefit purposes. In determining the proper status under a specific law, a worker's status relative to the Firm and relative to the Client Company generally must be determined separately.

III. ADVANTAGES OF USING THIRD-PARTY FIRMS

An employee leasing/PEO relationship involves a contractual allocation and sharing of employer responsibilities between the Third-Party Firm and its Client Company. The Third-Party Firm generally assumes responsibility and liability for human-resources issues and payroll-tax compliance, while the Client Company retains management and control of the day-to-day operation of its business. While both an employee leasing firm and PEO technically assign workers to a Client Company, a PEO offers a Client Company an opportunity to effectively "outsource" its entire human resources function. A PEO can take over as employer (and assign back to the Client Company) a Client Company's entire workforce. An employee leasing firm, by contrast, commonly assigns to its Client Company workers that represent a smaller portion of the Client Company's entire workforce. From a legal analysis standpoint, however, both are variations on the same concept.

Employee leasing firms may also be asked to locate and source worker talent, a function not normally provided by PEOs. While most large corporations have the financial resources and expertise to maintain familiarity and compliance with the vast and growing array of federal, state and local employment laws, many small-and medium-sized businesses cannot afford to do so. PEOs are intended to offer such businesses a solution by providing them with the services and expertise of a large, experienced personnel department, which, in turn, enables those businesses to better concentrate on their core business and ideally increase their profitability.

PEOs also can save companies money due to economies of scale. A PEO that employs thousands of workers can obtain more affordable health insurance rates and workers' compensation premiums than a small employer with, for instance, 50 employees. Moreover, PEOs most often handle the benefits and human resource functions for several companies, and can administer these functions more economically than individual companies could. The benefits of utilizing a PEO often inure not only to the Client Company but also to the company's workforce because, in many cases, workers will receive a greater quality and quantity of benefits from a PEO than they would receive from a small employer.

Staffing firms become specialists in advertising, recruiting, attracting, screening, hiring and onboarding new employees. The staffing firms generally act as the W-2 employer for payroll and benefits purposes. The real value-added proposition of staffing firms is the ability to locate and supply "ready-to-go" workers, often in large numbers, and serve as a pipeline for new, direct employees of Client Companies, and/or to help

manage large seasonal or contract-specific fluctuations in the Client Companies' workforces. Temporary workers are often seasonal, contract-specific, or "temporary-to-permanent" periods for workers to demonstrate skills and cultural fit within the Client Company.

IV. <u>INHERENT LEGAL RISKS AND MITIGATION</u>

In order to obtain the full benefit of its relationship with a Third-Party Firm, the Client Company must do more than simply contractually allocate responsibilities. An indemnification clause is not dispositive. On the contrary, the Client Company may still be found to be liable as a contingent worker's employer notwithstanding a contract with the PEO/Leasing Company in which the PEO agrees to indemnify the employer. The indemnification provision only shifts responsibility for paying damages associated with the liability to the party contracting for that liability. In the event the payor (Third-Party Firm) of that liability is insolvent or otherwise not able to cover the damages, the other party (Client Company) is still liable for the damages. Accordingly, the parties also must structure their respective relationships with the workers properly, so that the party responsible for a certain employer obligation actually qualifies as the workers' employer under the governing statutes.

A. RELEVANT LEGAL STANDARDS

The test for identifying an employment relationship, and all the liabilities attached thereto, in an employee-leasing arrangement with a Third Party-Firm is similar to the test used in differentiating between employees and independent contractors. The concept of joint employment is what qualifies a Staffing Agency as a worker's employer despite the fact that the worker may be performing duties at the Client Company's premises. As under the independent contractor factor tests, the joint employment concept considers the level and scope of control retained by either the Third-Party Firm or the Client Employer in determining whether an employment relationship exists. Joint employment status for both the Third-Party Firm and the Client Employer means that both may have legal duties to the worker, *e.g.*, the duty to withhold for federal taxes. As a general matter, the IRS takes the position that whoever is in control of the payment of wages is the "employer" for employment tax purposes.

While joint employment is helpful to Staffing Agencies that seek to qualify as a worker's employer, it may create potential pitfalls for Client Employers that enter into leasing arrangements precisely to avoid employer status. A determination that a Third-Party Firm and its clients are joint employers of leased workers can destroy some of the anticipated benefits of the leasing arrangement. It can also subject Client Employers to substantial liability for the Firm's acts or omissions, over which the Client Employer may have little to no control. Conversely, the Third-Party Firm can incur liability for workplace problems such as harassment by others in the Client Employer's workspace, over which

the agency may have little control. Accordingly, rights and responsibilities should be clearly established by *contract* from the outset.

B. POTENTIAL LIABILITIES RELATED TO CONTINGENT WORKERS

Throughout the Obama administration, companies faced increasing scrutiny from federal and state governments regarding alleged misclassification of workers as independent contractors. The U.S. Department of Labor (DOL) regularly declared its intention to "detect and deter" contingent worker misclassification, and entered into formal agreements to collaborate and share information with more than half of the states4 in addition to the Internal Revenue Service (IRS), which itself entered into "information sharing programs" with many state and local agencies to "uncover employment tax avoidance schemes and ensure proper worker classification."[5]

Under President Trump, the DOL has withdrawn some of its recent joint employer and independent contractor guidance, indicating an apparent break with the past.[6] However, individual states have given no such indication, and indeed may be spurred on in their audit efforts by budgetary and other local challenges.[7] Regardless of whether a classification is challenged by a state agency or private litigants, the potential liabilities regarding misclassified contingent workers are generally well known, as described below.

1. Tax Consequences

By far the most significant potential monetary legal exposure for contingent workers is unpaid federal and state taxes and unpaid overtime. The potential tax exposures for unpaid federal and state taxes, penalties and interest can be as high as 40% of the workers' income over a period of three years. Similarly, under the "economic realities" legal standard, it is highly likely a Client Employer utilizing temporary workers on a full time basis will be jointly liable for any alleged unpaid

[4] Updated information regarding formal agreements and Memoranda of Understanding between the DOL and various states is available at https://www.dol.gov/whd/state/statecoordination.htm.
[5] I.R.S., News Release No. IR-2007-184, IRS and States to Share Employment Tax Examination Results (2007); *see also* A Look at Information Sharing Agreements Between the IRS and States, FORBES, Aug. 7, 2015, available at http://www.forbes.com/sites/taxanalysts/2015/08/07/a-look-at-information-sharingagreements-between-the-irs-and-states/#54789b491a11 (as of July 2015 the IRS had 88 information sharing agreements with various state departments of revenue, labor and transportation).
[6] See "US Secretary of Labor Withdraws Joint Employment, Independent Contractor Informal Guidance," Release No. 17-0807-NAT, June 7, 2017, available at https://www.dol.gov/newsroom/releases/opa/opa20170607.
[7] *See*, *e.g.*, N.Y. Exec. Order No. 159, "Establishing A Permanent Joint Task Force to Fight Worker Exploitation and Employee Misclassification," July 2, 2016 (noting that misclassification "deprive[s] the State of substantial revenues while increasing the demand for payment for social services"), available at https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO_159.pdf.

overtime for a period of three years measured backwards from the date a lawsuit is filed (and the workers opt-in if applicable).[8]

Importantly, these are generally non-insurable risks. Insurance companies may agree to pay some portion of attorney fees (following a sizable deductible) for a class action wage claim, but the funds to settle claims of unpaid taxes and unpaid overtime will almost always be completely paid by the Client Employer. The Client Employer could be jointly and severally liable for unpaid taxes and overtime.

If the Staffing Firm cannot afford to pay, the Client Employer may be stuck with the liability. Likewise, failure to confirm that a Third-Party Firm is meeting its obligation to maintain employee records may have disastrous consequences.[9] However, assuming the workers are all paid on a W-2 basis, all taxes are withheld and remitted, are properly classified as exempt/nonexempt, and all worked overtime is paid, these exposures are essentially completely mitigated.

2. Workers' Compensation Insurance

It is always important to properly classify a worker under a state's workers' compensation laws. Client Employers should be aware of potentially restrictive classification procedures with respect to leased employees for workers' compensation purposes. For example, under California law, workers' compensation premiums trace back to the Client Employer for which the workers perform services. Should the employer misclassify an employee as an independent contractor, and charge the employee for workers' compensation premiums, that employee may recover as "damages incurred" any such premiums that the employee was obliged to pay.

3. Unemployment and Disability Contributions

Client Employers may also be required to pay state unemployment insurance tax for all wages the Client Employer pays. When a Staffing Agency and Client Employer allocate payroll responsibilities to the Staffing Agency, the agency is the party most likely to be responsible for remitting such payments. If, however, the agency fails to make these payments, the Client Employer would be secondarily liable as a co-employer.

---

[8] *See, e.g.*, *Barfield v. N.Y. City Health & Hosps. Corp.*, 537 F.3d 132, 138 (2d Cir. 2008) (finding joint employer status in an FLSA matter when the plaintiff performed work on the hospital's premises, using the hospital's equipment and the work was integral to the hospital's operation); *Bowerman v. Field Asset Servs.*, 2015 U.S. Dist. LEXIS 37988 (N.D. Cal. Mar. 24, 2015) (certifying class of third-party "vendors" (owners of businesses) defendant hired to provide cleaning services in suit alleging defendant systematically undercompensated them by classifying them as independent contractors);.

[9] *See, e.g., Secretary of Labor v. Caring First Inc.*, No. 15-cv-01824 (M.D. Fla. Oct. 20, 2017) (imposing sanctions on a Florida health staffing company for failing to suspend weekly deletion of payroll records, which the Court found constituted "willful destruction").

4. Benefits.

a. Affordable Care Act

The ACA utilizes a “common law control” standard to determine if someone is an employee. Workers who are fined several thousand dollars by the IRS for a failure to obtain health insurance (the “individual mandate”) will have an incentive to point the finger at the contracting entity to attempt to reduce the individual tax penalty.

Generally, all covered employers must offer qualifying health insurance to 95% of their “common law” employees. Misclassified IC’s and temporary workers not offered qualifying insurance coverage could cause the Client Employer to miss offering coverage to 95% of their workers.

The applicable fine would be $2,000 annually (prorated monthly) for every single full time employee of the Client Employer (this is the “A penalty” under the ACA) plus the allegedly misclassified contractors / temps, regardless of whether they were offered and accepted insurance coverage.

There is a legal safe harbor for the Client Employer, if the Staffing Agency offers qualifying minimum essential coverage AND if the Client Employer pays an increased premium or fee. This is usually demonstrated by an increased hourly rate or monthly or quarterly premium (*i.e.*, 50 cents more an hour or $150 per quarter) for workers who enroll for the insurance coverage.

b. 401k Plans and Employee Stock Purchase Plans

This is the most common reason why some companies enact a one-year “term limit” on the assignment of temporary/contingent workers. “Common law employees” who meet the years of service requirements cannot be excluded from tax-qualified employee stock purchase plans. This is not deemed to be special compensation and/or stock awards, which are immediately taxable, but rather a plan that allows all employees to purchase company stock at a discounted price, but defers the tax on the value of the discount.

Financial non-discrimination testing is required for 401K plans for all “leased employees” (this will very likely include temps who work in staff augmentation roles essentially doing the same job as direct full time employees) who work for more than 12 months and 1,500 hours (“IRS leased employee”).

If the percentage of collective temporary/contingent workers and potentially misclassified independent contractors ever becomes more than 30% of the total workforce of the company or a subsidiary company, significant legal exposures develop under the IRS Code if the workers provide services for more than 12 months. Penalties include potential disqualification of the 401k plan and significant (easily seven figure)

fines or penalties. Accordingly, if the total headcount of contingent workers within the organization starts reaching a critical mass (exceeding 20% perhaps), then exceptions to a one year term limit would need to be made sparingly.

Contingent and temporary workers might also try to assert rights in any pension or retirement plan, if they have the number of requisite years to vest in benefits – assuming they had been employed directly.[10]

c. ERISA & COBRA

Temporary and part-time workers will be entitled to full ERISA rights, if they are included in the terms of the relevant plan. However, a company can exclude part-time and temporary workers from benefit and pension plans, so long as they do not work 1,000 or more hours during one year of service. One thousand hours per year averages out to slightly less than 20 hours per week, so it is possible to lawfully exclude part-time workers from benefit plans.

Furthermore, leased or temporary employees may lawfully be excluded from a company's pension plan, although the exclusion of leased employees must be explicitly stated in the plan. It is also important to note that an employer sponsoring an ERISA plan must count leased employees for purposes of the minimum coverage and non-discrimination standards established by the IRS.

The consequences of failing to comply and excluding a part-time employee who otherwise qualifies for plan participation can be costly. The IRS mandates that employers correct such oversights by not only including the employee as a participant in the plan, but also by putting the participant in the same position as if he or she had not been excluded. Moreover, the IRS has previously issued a directive to its field agents stating that pension plans that exclude employees solely on the basis of their temporary part-time status risk losing their tax-qualified status under the Internal Revenue Code.

An additional consideration also merits mention. Some part-time employees may also be entitled to COBRA benefits. Employees going from full-time employment to part-time employment (or to independent contractor status) may be entitled to COBRA continuation coverage, due to the fact that their reduction in work hours no longer qualifies them for employer-provided medical benefits.

6. General Employment Laws

Not surprisingly, Title VII, the ADA and state EEO laws use a "common law" employee test (amount of control exerted) to determine joint employer status and

---

[10] *See, e.g., Shepard v. Lowe's HIW, Inc.*, 2013 U.S. Dist. LEXIS 118419 (N.D. Cal. Aug. 19, 2013) (certifying a class of workers in suit alleging defendant deprived product installers of benefits by improperly classifying them as independent contractors instead of employees).

potential liability. The ADEA, FMLA and OSHA apply the "economic realities" test. Under either test, using temporary and contingent workers to augment a Client Employer's workforce, and having them perform the same functions as regular direct employees, likely exposes the Client Employer to joint employer liability under all these statutes. Although these liabilities arguably arise from the first day the temporary worker is assigned, the longer the assignment lasts is a factor to be weighed in the totality of the circumstances when determining joint employer liability.

C. BEST PRACTICES

Written agreements with Staffing Agencies are critical, especially with indemnification provisions. However, they offer no absolute panacea, especially in leasing arrangements, as courts will apply common law and statutory employment tests and are not bound by the agreement language. In *Atchley v. Nordam Group, Inc.*, 180 F. 3d 1143 (10th Cir. 1999), for example, a Client Employer was held singularly liable for employment law violations with respect to leased employees, even though its agreement with the Staffing Agency expressly designated the leasing firm as the workers' employer for all purposes and the leasing firm indemnified the client company against the negligent acts of the leasing firm. Not only was the Client Employer held to be the worker's employer, in spite of the agreement language to the contrary, but the indemnification provision offered no help, because the court determined that the liability was not caused by any negligence of the Staffing Agency.

Client Companies may find their plans totally undone by a finding of joint employment, destroying most of the anticipated benefits of the contingent worker arrangement. For example, a Client Company may be exposed to audit risk or liability for the Third-Party Firm's acts or omissions in areas as to which the client has little control or visibility, such as errors made during the hiring process.[11] On the other side of the coin, the Third-Party Firm may incur unintended liability for problems such as harassment by others in the Client Company's workplace or plant safety problems.[12]

Client Employers and Third-Party Firms can mitigate unexpected joint-employer liability by structuring the leasing arrangement in such a way that the Client Company exercises little or no control over the leased employees. The following general

[11] States have increasingly regulated PEOs to avoid abuses relating to workers' compensation, fiscal mismanagement and tax evasion. A state-by-state overview of PEO regulations can be found at https://www.ncci.com/Articles/Pages/II_PEO_EmployeeLeasingGuidetoStateSpecificRequirements.aspx. In addition, an independent, nonprofit accreditation body, the Employer Services Assurance Corporation, evaluates PEOs according to ethical, financial and operational standards as well as performance of employer obligations. *See* https://www.esac.org/about-esac.

[12] *See, e.g.*, Cal/OSHA Issues $256,445 in Citations to Warehouse Operators, June 18, 2012, available at https://www.dir.ca.gov/DIRNews/2012/IR2012-03.html (press release from Cal/OSHA regarding citations issued to a warehouse owner and its temporary staffing contractor, found to be dual employers, for more than 60 violations at four warehouses).

guidelines will increase the likelihood that the Third-Party Firm will qualify as a co-employer (thereby mitigating Client Company's liabilities):

1. Relationship between the Firm and the Client Company

- The Third-Party Firm's duty to pay wages to workers should not be conditioned on receipt of funds from the Client Employer.

- The Third-Party Firm should bill the Client Employer a flat hourly rate without any disclosure of the allocation of the hourly rate as between wages, payroll taxes, benefits and profit. Where possible, the Firm should not inform the Client Employer of the wage rate being paid to their leased employees (this is especially important for federal income tax purposes).

- The Third-Party Firm should conduct periodic on-site visits to assess and address human resource issues. Ideally, this would be done by assigning to a Client Employer a firm representative. The Client Company should direct human resources issues relating to the contingent worker to the Firm.

- Recordkeeping and reporting of hours worked and general employment records should be handled and maintained by the Third-Party Firm, not the Client Company.

- Performance evaluations and discipline should be the responsibility of the Third-Party Firm, and the Client Company should avoid direct or indirect control or reservation of rights concerning hiring, firing and other human resources decisions. The Third-Party Firm may consider the Client Company's advice, but should retain the ultimate right to make such decisions. Meanwhile, the Client Company may retain day-to-day oversight of matters relating to its core business.

- Recognizing that the agreement between the Client Company and the Third-Party Firm may not be dispositive of joint employment status, (and certainly, no agreement can completely prevent employment claims from being raised!), the agreement should include appropriate and enforceable indemnification and insurance requirements, and the Client Company should perform sufficient pre-contracting diligence to confirm that the Third-Party Firm is reputable and actually will meet its employer obligations with regard to contingent workers.[13]

---

[13] *See* National Association of Professional Employer Organizations (NAPEO), *Guidelines for Choosing a PEO*, available at http://napeo.org/what-is-a-peo/selecting-a-peo/guidelines-for-choosing-a-peo.

2. Relationship Among the Third-Party Firm, The Client Company and the Contingent Workers

a. Do's and Dont's for The Client Employer

- DO NOT handle the record keeping or reporting of hours worked by the contingent workers. This should be handled by the Third-Party Firm.
- DO NOT maintain any employment records apart from emergency information.
- DO NOT be responsible for conducting employee evaluations and taking action based on those evaluations.
- DO NOT retain the right to make hiring and firing decisions.
- DO NOT provide own handbook/policies to the contingent workers; rather, require the Third-Party Firm to provide its own.
- DO direct all internal and external communications pertaining to human resource issues to the Third-Party Firm representative responsible for the Client Employer.
- DO communicate to the Third-Party Firm's representative if dissatisfied with a worker's performance, rather than to the Client Employer's own operational managers or human resources representatives. Immediate issues related to workplace safety or conduct may be addressed by appropriate Client personnel on a timely basis, but broader questions about discipline or termination should be handled by the Third-Party Firm.

b. Meanwhile, The Third-Party Firm Should:

- Maintain an employee handbook that covers policies such as timekeeping, complaint processes, conduct standards, injury protocols and other common employment and benefits policies.
- Establish policies for complying with applicable laws and regulations and should provide managers and supervisors with related manager training.
- Set up its own standardized guidelines for expense reimbursement, including travel, rather than referring to the Client Company for these matters.

- Establish its own policies for reporting of time and paid time off, and should calculate the amount of wages payable as well as payroll taxes. This information (other than hours worked) should not be shared with the Client Company.
- Handle screenings, including background checks, drug testing and I-9 eligibility verifications, in compliance with all federal, state and local requirements, rather than having the Client Company perform any of these.

V. APPENDIX OF RELEVANT LEGAL STANDARDS

Generally, the test for identifying potential joint employer liability in this area is similar to the test used in differentiating between employees and non-employees or independent contractors in the relevant jurisdiction. Some examples of this analysis include the following:

- A client company of a staffing firm was found to be the employer of a temporary staffing employee. Although the staffing firm handled all administrative functions (e.g., maintaining personnel and payroll records, paying staff and making withholdings, making unemployment contributions), the hiring and firing decisions were made only upon approval or at the request of the client company at which the plaintiff was placed and the plaintiff's job performance had been evaluated only by the client company. [14]

- The parent company of 38 rental care facilities was determined not to be a joint employer of the subsidiaries' assistant managers, where the parent company (1) had no authority to hire or fire assistant managers, promulgate work rules or assignments, or set compensation, benefits, schedules, or rates or methods of payment; (2) was not involved in supervision or discipline; and (3) did not exercise or maintain any control over employee records.[15] A "joint employment" determination between financially related companies, such as parent and subsidiary or sister companies, is called the "integrated enterprise" test.

- A nightclub owner who was a member of the limited liability company that purchased the nightclub was determined not to be a joint employer because he did not exert any operational control over the nightclub's employees.[16]

---

[14] *Johnson v. Manpower Prof'l Servs., Inc.*, 442 F. App'x 977 (5th Cir. 2011).
[15] *In re Enterprise Rent-A-Car Wage & Hour Empl. Practices Litig.*, 683 F.3d 462.
[16] *Gray v. Powers*, 673 F.3d 352 (5th Cir. 2012) (declining to adopt a rule that would impose individual liability on all shareholders, members and officers of entities that are employers under the FLSA based on their position rather than the economic reality of their involvement in the business).

- A shipping company was determined not to be a joint employer of a contractor's drivers, where the totality of the economic circumstances indicated that the drivers were not economically dependent upon the shipping company. [17]

For convenience, set forth below are the primary legal tests used to determine whether an individual is an independent contractor. Please note that this list is not exhaustive, but is merely intended to outline the various sets of factors considered by government agencies and courts in determining independent contractor status.

A. IRS Test

The IRS (and some states) uses a 20-factor test to determine whether a person is an employee or contractor. The factors are:

(1) No instructions: Whether a worker is required to comply with other persons' instructions about when, where, and how he is to work is ordinarily an employee.

(2) No training: Training suggests that a worker is an employee.

(3) No integration: Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control and is an employee.

(4) Services do not have to be rendered personally: If the services must be rendered personally, this will weigh in favor of the worker being considered an employee.

(5) Control over their own assistants: If one worker hires, supervises, and pays the other assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status.

(6) Not a continuing relationship: A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists.

(7) Work hours are set by the worker: The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control.

---

[17] *Layton v. DHL Express*, 686 F.3d 1172 (11th Cir. 2012).

(8) Time to pursue other work: An independent contractor is free to work when and for whom he chooses.

(9) Worker can choose job location: If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Work done off the premises of the person or persons receiving the services, such as at the office of the worker, indicates some freedom from control.

(10) No requirements on the order or sequence of work: An employee usually must perform services in the order or sequence set by employer.

(11) No required reports: A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control.

(12) Payment for the result: Payment by the hour, week, or month is generally associated with an employer-employee relationship.

(13) The worker pays his own business expenses: If the person or persons for whom the services are performed usually pay the worker's business and/or traveling expenses, the worker is ordinarily an employee.

(14) The worker uses his own tools: The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship.

(15) The worker invests in facilities: If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees, that factor tends to indicate that the worker is an independent contractor.

(16) The worker realizes a profit or loss as a result of worker's services: A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor.

(17) The worker works for more than one firm at a time: If a worker performs more than de minimis services for several unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor.

(18) Worker makes his services available to the general public: The fact that a worker makes his services available to the general public on a regular and consistent basis indicates an independent contractor relationship.

(19) Business has a limited right to discharge the worker: The right to discharge a worker is a factor indicating that the worker is an employee, and the person possessing the right is an employer.

(20) Worker cannot leave without incurring potential liability for incomplete job: If the worker has the right to end the relationship with the person for whom the services are performed at any time he wishes without incurring liability, that factor indicates an employer-employee relationship.

The IRS has condensed this lengthy list of factors into a three element test, based on: (1) behavioral control; (2) financial control; and (3) the relationship of the parties. Behavioral control takes into account the amount of day-to-day control and direction the business exercises over the worker's actions. The financial control element examines the monetary aspects of the relationship, such as the worker's opportunity for profit or loss, the reimbursement of expenses, and the method of payment. Under the relationship-of-the-parties element, the IRS considers how the parties interact, including the parties' intent, whether the worker is provided benefits, whether the worker can be discharged at-will, and whether the work is a key aspect of the company's business.

B. Economic Realities Test

Several federal statutes (such as the FLSA, the ADEA and the FMLA) use the "economic realities" test. The economic realities test focuses on whether a worker is economically dependent on the business to which he provides services (in which case the worker is deemed an employee), or whether the worker is financially independent and effectively in business for himself (in which case he is deemed an independent contractor). Application of the economic realities test varies somewhat from one federal Circuit Court to another, but essentially involves examination of the same factors. As an example, courts applying the test in the Ninth Circuit considers whether the company: (1) has the power to hire and fire the worker; (2) controls the hours or work and/or other employment conditions; (3) controls the level and method of payment; and (4) maintains employment related records.

C. "ABC" Test

The "ABC" test is most widely used when determining independent contractor status under state unemployment statutes. This test consists of three separate elements, each of which must be met for a person to be considered an independent

contractor—an “A” test, a “B” test and a “C” test, generally requiring a business to show that:

A. the individual has been and will continue to be free from any control or direction over the performance of such services both under his contract and in fact; and

B. the service is either outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprise for which such service is performed; and

C. the individual is customarily engaged in an independently established trade, occupation, profession or business

D. California

California is a particularly hostile state to the independent contractor model.[18] On February 7, 2018, the California Supreme Court heard oral argument in the case of heard oral argument in the case of *Dynamex Operations v. Superior Court,* which will address the legal standard for independent contractor classification and is expected to be highly significant for California entities that use contingent labor.

For now, California courts apply the test adopted in *Borello*, which focuses on whether the putative employer, “has the right to control the manner and means of accomplishing the result desired,” as well as a host of secondary factors. *S.G. Borello & Sons, Inc. v. Department of Industrial Relations,* 48 Cal.3d 341, 350-51,354-55 (1989). Those secondary factors include the following:

[18]Companies that utilize independent contractors in California face a particularly difficult legal climate. For example, in *Estrada v. FedEx Ground Package System, Inc.*, 154 Cal. App. 1 (2007), which involved claims under California's wage and hour laws, the court found that FedEx drivers were employees, not independent contractors, and in June 2008, after nearly ten years of litigation, FedEx agreed to pay $27,000,000 to resolve the judgment. With barely more than 200 class members, the *Estrada* decision resulted in a damages award of $14,500,000. Payments to the 203 class members ranged from $2,000 up to $280,000, with an average payment amount of $70,000. (*See* December 8, 2008 Press Release: "$27 Million Final Judgment In Landmark California FEDEX Employee-Misclassification Case," Lynn Rossman Faris.) Similarly, *Alexander v. FedEx Ground Package System, Inc.*, 765 F.3d 981 (9th Cir. 2014), a case also contesting the independent contractor status of FedEx's drivers, recently settled for $228,000,000. (*See* San Francisco Business Times Morning Edition, June 16, 2015: "Why Fedex's $228 million settlement may dent Uber, Lyft, Postmates, Homejoy and Caviar.") The *Estrada and* Alexander actions illustrate the risks involved in misclassification cases.

(a) the right to discharge at will without cause;

(b) whether the worker is engaged in a distinct occupation or business;

(c) the skill required in the occupation;

(d) whether the worker pays for equipment and other business expenses; (e) the length of time for which services are to be performed;

(e) the method of payment, whether by the hour or by the job;

(f) whether the work performed is part of the regular business of the putative employer;

(g) whether or not the parties believe they are creating an employer-employee relationship;

(h) the worker's opportunity for entrepreneurial profit or loss depending upon his/her managerial skills;

(i) the worker's use of helpers/replacements;

(j) the degree of permanence of the working relationship; and

(k) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of an employer or by a specialist without supervision.

The test is applied by weighing these factors as a whole, rather than applying them mechanically as separate tests.