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# The Contingent Workforce: Best Practices in an Uncertain Legal Landscape

**February 22, 2016**

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# The Contingent Workforce: Best Practices in an Uncertain Legal Landscape

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**INDEPENDENT CONTRACTOR OR EMPLOYEE?**
**THE DEPARTMENT OF LABOR WEIGHS IN**

**By Chad K. Lang, Esq. and Kim M. Lucas, Esq.,**
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## I. Summary of U.S. Department of Labor AI No. 2015-1

On July 15, 2015, the U.S. Department of Labor (the "DOL") issued AI No. 2015-1 (the "Memo") providing new guidance for the classification of workers that qualify as "employees" under the Fair Labor Standards Act and the Family Medical Leave Act.[1] The Memo illustrates the analysis used by the DOL when determining the correct classification of a worker, the "economics realities" test. According to the DOL, the "economics realities" test should be applied broadly in light of the expansive definition of "employ"[2] under the Fair Labor Standards Act (the "FLSA"). Given such application, the DOL opined that "most workers are employees."

Throughout the DOL's application of the multi-factor "economics realities" test, the DOL's main focus is whether a worker is "economically dependent" on the employer or whether the worker is truly operating a business on his/her own. The economic reality of the employer/worker relationship is the dispositive factor that determines the correct classification of the worker, and not the label the employer assigns the worker. Even if the worker and the employer agree in writing that the worker should be designated as an independent contractor, the agreement is not legally binding and does not label the relationship in the eyes of the DOL. Furthermore, an employer should not

[1] The misclassification of employees not only covers workers who are labeled as independent contractors, but also covers workers who are labeled something else, such as owners, partners or members.

[2] The FLSA defines "employ" broadly as including "to suffer or permit work." 29 U.S.C. 203(g).

take comfort that it has protected itself simply because it issued a Form 1099-MISC to a worker. According to the DOL, Form 1099-MISC only signifies that the employer engaged the worker as an independent contractor, but it does not indicate that the worker is indeed an independent contractor under the law.

### A. <u>The Economic Realities Test as Applied by the DOL</u>

The DOL illustrated how it applies the economic realities' factors to determine if a worker is an employee or an independent contractor. All the factors should be evaluated equally, with no single factor outweighing another, to provide the evaluator with a totality of circumstances surrounding the relationship. Each factor is discussed below.

#### 1. Is the Work an Integral Part of the Employer's Business?

The DOL examines whether the work being performed by the worker is integral to the employer's business. It is more likely that the worker is "economically dependent" on the employer (and therefore an employee) if the work performed by a worker is integral to the employer's business. The "integral" component is not only compelling to the DOL, but also to courts. The DOL provided examples for guidance. For instance, a cake decorator is an integral part of a business selling cakes that are custom decorated. Pickling is an integral part of a pickle business. A contractor is an integral part of a construction business. On the other hand, a software developer who creates a program for the construction business is NOT an integral part of the construction business.

Work can still be deemed an integral part of the business even if the work is performed "away from the employer's premises, at the worker's home, or on the customer's premises." Work can also be integral to a business even if it is merely just one component of the business or even if it is performed by hundreds or thousands of others. For instance, a call center worker is an integral part of a call center, even if hundreds of others are performing the same job or even if it is being performed remotely from that person's home.

### 2. Does the Worker's Managerial Skill Affect the Worker's Opportunity for Profit or Loss?

In this inquiry, the DOL focuses on whether the worker exercises managerial skills and judgments that affect his/her opportunity for both profits and losses. The possibility of loss is associated with independent contractor status. For example, the business judgment of an installer to make capital investments in tools, equipment and trucks indicates independent contractor status. The decision to hire other workers or to work alone is indicative of independent contractor status. The ability to choose how many hours to work is also indicative of independent contractor status. Carefully consider whether the loss is simply a loss of wages (indicating employee status) or a loss of profit (indicating non-employee status). A farm hand may lose wages because the harvest was not abundant, but he/she does not lose the profit made by the farm.

### 3. How Does the Worker's Relative Investment Compare to the Employer's Investment?

Even if a worker has made a substantial investment, it should not be considered by itself. An analysis of a worker's investment should be considered in comparison to the employer's investment. The DOL stated that the investment of a true independent contractor would further the business's capability to expand, reduce cost structure, or extend the market reach. Investing in tools and equipment does not always indicate independent contractor status. An oil rig worker may invest tens of thousands of dollars for an equipped truck, but that investment pales in comparison to the investment of hundreds of thousands of dollars for equipment at the work site made by the employer. The oil rig worker would be an employee. A farm hand may invest in specific tools that she/he prefers to use to work, such as work gloves and garden tools, but that investment is minimal to the investment of the employer who pays for farm equipment, land and fertilizers. The farm hand would be an employee. Carefully compare the worker's investment with that of the employer to determine if the worker is truly an independent business or simply an employee.

**4. Does the Work Performed Require Special Skill and Initiative?**

A worker with special skills, such as carpenters, cable installers, and electricians, does not necessarily indicate independent contractor status. For skills to be indicative of independent contractor status, they should be used in some independent way, such as demonstrating business-like initiative. Only carpenters, cable installers, and electricians who operate their own businesses by providing services to a variety of companies, marketing their own services, determining when to order materials and determining on which projects to work demonstrate independent contractor status. If the skilled worker is primarily economically dependent on the same employer and it is that employer who picks the jobs, then the skilled worker is an employee.

**5. Is the Relationship between the Worker and the Employer Permanent or Indefinite?**

Permanency or indefiniteness indicates employee status. Workers who continue to work until they quit or are terminated are employees. However, lack of permanence or indefiniteness does not necessarily indicate independent contractor status. This factor requires careful consideration to determine if the reason for the indefiniteness or non-permanency is because the worker is operating an independent business. If so, then the worker is indeed an independent contractor. The key to the indefiniteness and/or non-permanency evaluation is whether the indefiniteness and/or non-permanency is due to operational characteristics intrinsic to the business, such as seasonal operations of some resort hotels, or whether the indefiniteness and/or non-permanency is due to the worker's own business initiatives. Seasonal businesses can still have employees, even if the work is not "permanent."

### 6. What is the Nature and Degree of the Employer's Control?

In order to be considered an independent contractor, the worker must control meaningful aspects of the work being performed. It is not what the worker could have controlled, but rather what the worker actually does control that is dispositive. However, an employer's lack of control is not necessarily determinative when a worker telecommutes or works offsite. Employers who control aspects of the worker's jobs indicate an employee status, even if the motivation for such control is the nature of the business, regulatory requirements or customer satisfaction. These control aspects can include who sets the pay, who sets the schedules, who establishes the dress code, and who assigns the tasks.

The DOL points out that employee status is not defeated if the worker is economically dependent on the employer, even if the employer does not exert the requisite control. The "control" factor does not overtake all the other factors. Like the other factors, the "control" factor should be analyzed to determine if the worker is in business for himself/herself or economically dependent on the employer.

## II. Has Anything Changed Since the DOL's Memo?

In 2010, the DOL began its initiative on misclassification and announced that it would target the increasing problem. Thereafter, the DOL and the IRS entered into a Memorandum of Understanding to coordinate their efforts to fight independent contractor misclassification. The recently issued Memo does not change the legal landscape. It is simply just another chapter of the DOL's initiative that began in 2010.

However, the Memo does highlight the DOL's new emphasis on "economic dependence." More importantly, the DOL's statement that "most workers are employees" will only bolster the DOL to become more aggressive in pursuing employee misclassification. In fact, as of November 2015, twenty-six (26) state labor departments have entered into memorandums of understanding with the DOL to share information and conduct joint investigations regarding independent contractor misclassifications.[3]

The Payroll Fraud Prevention Act (the "Bill") was reintroduced in Congress in July 2015. This Bill, if passed, would: 1) require employers to provide written notice to workers regarding his/her classification as an employee or independent contractor; 2) require that the employer's written notice contain information directing workers to the DOL employee rights resources webpage; and 3) require that records kept in accordance with the FLSA must also include an accurate classification of the worker as an employee or independent contractor. The Bill also creates a rebuttable presumption that the worker would be classified as an employee, if the employer fails to provide the written notice of classification to the worker. Worker misclassifications would become a violation of the FLSA, subjecting employers not only to double liquidated damages, but

[3] Alabama, Alaska, Arkansas, California, Colorado, Connecticut, Florida, Hawaii, Idaho, Illinois, Iowa, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Montana, New Hampshire, New York, Rhode Island, Texas, Utah, Vermont, Washington, Wisconsin and Wyoming.

also civil penalties up to $1,100 for each misclassification and up to $5,000 when such violations are repeated or willful.

## III. Practical Tips

- Avoid contractor arrangements where the work being performed is an integral part of the business. If you truly cannot conduct the business (or a line of business, if the company has more than one) without the work the contractor(s) is doing, it is likely an employment relationship exists.

- Avoid hiring a contractor who works every week for the business or even part time every week for the business, which gives the appearance of economic dependence. If a company has access to a large independent contractor workforce, it is better to hire a large group of contractors, so no one is working a regular schedule, instead only working sporadically. While this may not win the day, it helps build a defense against an audit or lawsuit.

- Do not rely on independent contractor agreements or Forms 1099-MISC to define the worker relationship. But when using agreements, be sure to include key factors of the independent contractor's job that fit the DOL factors weighing in favor of independent contractor status. And ensure that those factors actually apply to the independent contractor's actual job duties.

- Remember that an employee cannot privately waive his/her FLSA rights. So even if the individual requests to be an independent contractor and/or to receive a 1099, s/he may still be considered an employee based upon the economic realities analysis.

- Avoid having employees perform essentially the same duties as your independent contractors.

- Avoid hiring a terminated employee as an independent contractor to perform essentially the same duties performed in the past. This is pretty much a dead giveaway that the independent contractor is really an employee.

- Don't wait for the DOL to conduct an investigation or for a lawsuit to be filed. Perform a self-audit and, if possible, involve an attorney in the audit. If nothing else, the legal opinion may help avoid a 3-year damages period (instead only allowing an employee to recover for a 2-year period because the company's conduct was not willful) and/or prevent or limit a liquidated (double) damages claim.

- If it's a close call, reclassify that worker as an employee because employers have the burden to establish that their classification as an independent contractor is accurate.

- Require independent contractors to carry appropriate insurance(s) (general liability, workers' compensation).

- Ensure that your independent contractors have the appropriate business licenses, including a Federal Employer Identification Number issued by the IRS. Do not accept social security numbers.

- If a business thinks it may have misclassified workers, it should consider entering into the IRS's Voluntary Classification Settlement Program, which allows employers to reclassify workers as employees without being subjected to an IRS audit or administrative correction procedures. The IRS will also waive a large portion of the back tax liability for misclassified workers, including penalties and interest. But consult an attorney before doing so.

- Misclassifying employees as independent contractors may expose a company to liability under many laws beyond the FLSA for wage and hour violations. Some of them are as follows:

    - Affordable Care Act violations
    - Employment Tax violations
    - Workers' compensation issues
    - ERISA/benefits
    - Family and Medical Leave Act issues
    - FICA tax issues
    - Payroll tax issues such as social security and medicare
    - Issues with workplace safety and health requirements
    - Payment of interest on unpaid taxes

Be aware that some states have their own laws penalizing companies for misclassifying employees as independent contractors. For example, California, New York, Delaware and Illinois have such laws, some of which may impose a civil penalty up to $50,000 for a willful violation or $1500 per day for each violation per worker.

U.S. Department of Labor
Wage and Hour Division
Washington, D.C. 20210

**Administrator's Interpretation No. 2015-1**

July 15, 2015

Issued by ADMINISTRATOR DAVID WEIL

SUBJECT: The Application of the Fair Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who Are Misclassified as Independent Contractors.

Misclassification of employees as independent contractors is found in an increasing number of workplaces in the United States, in part reflecting larger restructuring of business organizations. When employers improperly classify employees as independent contractors, the employees may not receive important workplace protections such as the minimum wage, overtime compensation, unemployment insurance, and workers' compensation. Misclassification also results in lower tax revenues for government and an uneven playing field for employers who properly classify their workers. Although independent contracting relationships can be advantageous for workers and businesses, some employees may be intentionally misclassified as a means to cut costs and avoid compliance with labor laws.

The Department of Labor's Wage and Hour Division (WHD) continues to receive numerous complaints from workers alleging misclassification, and the Department continues to bring successful enforcement actions against employers who misclassify workers. In addition, many states have acknowledged this problematic trend and have responded with legislation and misclassification task forces. Understanding that combating misclassification requires a multi-pronged approach, WHD has entered into memoranda of understanding with many of these states, as well as the Internal Revenue Service.[1] In conjunction with these efforts, the Administrator believes that additional guidance regarding the application of the standards for determining who is an employee under the Fair Labor Standards Act (FLSA or "the Act") may be helpful to the regulated community in classifying workers and ultimately in curtailing misclassification.

The FLSA's definition of employ as "to suffer or permit to work" and the later-developed "economic realities" test provide a broader scope of employment than the common law control test. Indeed, although the common law control test was the prevalent test for determining whether an employment relationship existed at the time that the FLSA was enacted, Congress rejected the common law control test in drafting the FLSA. *See Walling v. Portland Terminal*

[1] Information about the Department's Misclassification Initiative and related memoranda of understanding is available at http://www.dol.gov/whd/workers/misclassification/.

*Co.*, 330 U.S. 148, 150-51 (1947). Instead, the FLSA defines "employ" broadly as including "to suffer or permit to work," 29 U.S.C. 203(g), which clearly covers more workers as employees, *see U.S. v. Rosenwasser*, 323 U.S. 360, 362-63 (1945).

In order to make the determination whether a worker is an employee or an independent contractor under the FLSA, courts use the multi-factorial "economic realities" test, which focuses on whether the worker is economically dependent on the employer or in business for him or herself.[2] A worker who is economically dependent on an employer is suffered or permitted to work by the employer. Thus, applying the economic realities test in view of the expansive definition of "employ" under the Act, most workers are employees under the FLSA. The application of the economic realities factors must be consistent with the broad "suffer or permit to work" standard of the FLSA.

This Administrator's Interpretation first discusses the pertinent FLSA definitions and the breadth of employment relationships covered by the FLSA. When determining whether a worker is an employee or independent contractor, the application of the economic realities factors should be guided by the FLSA's statutory directive that the scope of the employment relationship is very broad. This Administrator's Interpretation then addresses each of the factors, providing citations to case law and examples. All of the factors must be considered in each case, and no one factor (particularly the control factor) is determinative of whether a worker is an employee. Moreover, the factors themselves should not be applied in a mechanical fashion, but with an understanding that the factors are indicators of the broader concept of economic dependence. Ultimately, the goal is not simply to tally which factors are met, but to determine whether the worker is economically dependent on the employer (and thus its employee) or is really in business for him or herself (and thus its independent contractor). The factors are a guide to make this ultimate determination of economic dependence or independence.[3]

## I. The Economic Realities Factors Should Be Applied in View of the FLSA's Broad Scope of Employment and "Suffer or Permit" Standard

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[2] While most misclassified employees are labeled "independent contractors," the Department has seen an increasing number of instances where employees are labeled something else, such as "owners," "partners," or "members of a limited liability company." In these instances, the determination of whether the workers are in fact FLSA covered employees is also made by applying an economic realities analysis.

[3] The analysis in this Administrator's Interpretation should also be applied in determining whether a worker is an employee or an independent contractor in cases arising under the Migrant and Seasonal Agricultural Worker Protection Act (MSPA) and the Family and Medical Leave Act (FMLA). MSPA expressly adopts the FLSA's definition of "employ" as MSPA's definition of "employ" and thus incorporates the broad "suffer or permit" standard for determining the scope of employment relationships. *See* 29 U.S.C. 1802(5) ("The term 'employ' has the meaning given such term under [the FLSA, 29 U.S.C. 203(g)]."); *see also* 29 C.F.R. 500.20(h)(1)-(4). The FMLA also adopts the FLSA's definition of "employ" for employer coverage and employee eligibility purposes (subject to additional eligibility requirements). *See* 29 U.S.C. 2611(3); 29 C.F.R. 825.105.

The FLSA's definitions establish the scope of the employment relationship under the Act and provide the basis for distinguishing between employees and independent contractors. The FLSA defines "employee" as "any individual employed by an employer," 29 U.S.C. 203(e)(1), and "employer" as including "any person acting directly or indirectly in the interest of an employer in relation to an employee," 29 U.S.C. 203(d). The FLSA's definition of "'employ' includes to suffer or permit to work." 29 U.S.C. 203(g). This "suffer or permit" concept has broad applicability and is critical to determining whether a worker is an employee and thus entitled to the Act's protections.

The "suffer or permit" standard was specifically designed to ensure as broad of a scope of statutory coverage as possible. *See Rosenwasser*, 323 U.S. at 362-63 ("A broader or more comprehensive coverage of employees . . . would be difficult to frame."); *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992) ("employ" is defined with "striking breadth"). The Supreme Court "has consistently construed the Act 'liberally to apply to the furthest reaches consistent with congressional direction,' recognizing that broad coverage is essential to accomplish the [Act's] goal . . . ." *Tony & Susan Alamo Found. v. Sec'y of Labor*, 471 U.S. 290, 296 (1985) (quoting *Mitchell v. Lublin, McGaughy & Assocs.*, 358 U.S. 207, 211 (1959)) (internal citation omitted).

The history of the "suffer or permit" standard highlights its broad applicability. Prior to the FLSA's enactment, the phrase "suffer or permit" (or variations of the phrase) was commonly used in state laws regulating child labor and was "designed to reach businesses that used middlemen to illegally hire and supervise children." *Antenor v. D & S Farms*, 88 F.3d 925, 929 n.5 (11th Cir. 1996). A key rationale underlying the "suffer or permit" standard in child labor laws was that the employer's opportunity to detect work being performed illegally and the ability to prevent it from occurring was sufficient to impose liability on the employer. *See, e.g.*, *People ex rel. Price v. Sheffield Farms-Slawson-Decker Co.*, 225 N.Y. 25, 29-31 (N.Y. 1918). Thus, extending coverage of child labor laws to those who suffered or permitted the work was designed to expand child labor laws' coverage beyond those who controlled the child laborer, counter an employer's argument that it was unaware that children were working, and prevent employers from using agents to evade requirements.

Unlike the common law control test, which analyzes whether a worker is an employee based on the employer's control over the worker and not the broader economic realities of the working relationship, the "suffer or permit" standard broadens the scope of employment relationships covered by the FLSA. Indeed, the FLSA's statutory definitions (including "suffer or permit") rejected the common law control test that was prevalent at the time. As the Supreme Court explained:

> [I]n determining who are "employees" under the Act, common law employee categories or employer-employee classifications under other statutes are not of controlling significance. This Act contains its own definitions, comprehensive enough to require its application to many persons and working relationships, which prior to this Act, were not deemed to fall within an employer-employee category.

*Walling*, 330 U.S. at 150-51 (internal citation omitted); *see also Darden*, 503 U.S. at 326 (FLSA's "suffer or permit" standard for employment "stretches the meaning of 'employee' to cover some parties who might not qualify as such under a strict application of traditional agency law principles."); *Antenor*, 88 F.3d at 933 ("Indeed, the 'suffer or permit to work' standard was developed to assign responsibility to businesses that did not directly supervise putative employees."). Thus, the scope of employment under the FLSA is the "'broadest definition that has ever been included in any one act.'" *Rosenwasser*, 323 U.S. at 363 n.3 (quoting from statement of Senator Black on Senate floor).

An "entity 'suffers or permits' an individual to work if, as a matter of economic reality, the individual is dependent on the entity." *Antenor*, 88 F.3d at 929. The Supreme Court and Circuit Courts of Appeals have developed a multi-factor "economic realities" test to determine whether a worker is an employee or an independent contractor under the FLSA. *See, e.g., Tony & Susan Alamo*, 471 U.S. at 301 (noting that the test of employment under the FLSA is economic reality); *Goldberg v. Whitaker House Co-op, Inc.*, 366 U.S. 28, 33 (1961) (the economic realities of the worker's relationship with the employer control, rather than any technical concepts used to characterize that relationship). The factors typically include: (A) the extent to which the work performed is an integral part of the employer's business; (B) the worker's opportunity for profit or loss depending on his or her managerial skill; (C) the extent of the relative investments of the employer and the worker; (D) whether the work performed requires special skills and initiative; (E) the permanency of the relationship; and (F) the degree of control exercised or retained by the employer.[4]

In undertaking this analysis, each factor is examined and analyzed in relation to one another, and no single factor is determinative. The "control" factor, for example, should not be given undue weight. The factors should be considered in totality to determine whether a worker is economically dependent on the employer, and thus an employee. The factors should not be applied as a checklist, but rather the outcome must be determined by a qualitative rather than a quantitative analysis. The application of the economic realities factors is guided by the overarching principle that the FLSA should be liberally construed to provide broad coverage for workers, as evidenced by the Act's defining "employ" as "to suffer or permit to work."

In applying the economic realities factors, courts have described independent contractors as those workers with economic independence who are operating a business of their own. On the other hand, workers who are economically dependent on the employer, regardless of skill level, are employees covered by the FLSA. *See, e.g., Hopkins v. Cornerstone Am.*, 545 F.3d 338, 343 (5th Cir. 2008) ("To determine if a worker qualifies as an employee, we focus on whether, as a matter of economic reality, the worker is economically dependent upon the alleged employer or is instead in business for himself."); *Baker v. Flint Eng'g & Constr. Co.*, 137 F.3d 1436, 1440 (10th Cir. 1998) (the economic realities of the relationship govern, and the focal point is whether the individual is economically dependent on the business to which he renders service or is, as a matter of economic fact, in business for himself); *Brock v. Superior Care, Inc.*, 840 F.2d 1054,

[4] The number of factors and the exact articulation of the factors may vary some depending on the court. Courts routinely note that they may consider additional factors depending on the circumstances and that no one factor is determinative.

1059 (2d Cir. 1988) ("The ultimate concern is whether, as a matter of economic reality, the workers depend on someone else's business . . . or are in business for themselves."). "Ultimately, in considering economic dependence, the court focuses on whether an individual is 'in business for himself' or is 'dependent upon finding employment in the business of others.'" *Scantland v. Jeffry Knight, Inc.*, 721 F.3d 1308, 1312 (11th Cir. 2013) (quoting *Mednick v. Albert Enters., Inc.*, 508 F.2d 297, 301-02 (5th Cir. 1975)).

Moreover, the economic realities of the relationship, and not the label an employer gives it, are determinative. Thus, an agreement between an employer and a worker designating or labeling the worker as an independent contractor is not indicative of the economic realities of the working relationship and is not relevant to the analysis of the worker's status. *See, e.g.*, *Scantland*, 721 F.3d at 1311 ("This inquiry is not governed by the 'label' put on the relationship by the parties or the contract controlling that relationship, but rather focuses on whether 'the work done, in its essence, follows the usual path of an employee.'") (quoting *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 729 (1947)); *Superior Care*, 840 F.2d at 1059 ("[E]mployer's self-serving label of workers as independent contractors is not controlling."); *Robicheaux v. Radcliff Material, Inc.*, 697 F.2d 662, 667 (5th Cir. 1983) (explaining that "[a]n employee is not permitted to waive employee status," and affirming that welders were employees despite having signed independent contractor agreements). Likewise, workers who are classified as independent contractors may receive a Form 1099-MISC from their employers. This form simply indicates that the employer engaged the worker as an independent contractor, not that the worker is actually an independent contractor under the FLSA. *See Olson v. Star Lift Inc.*, 709 F. Supp. 2d 1351, 1356 (S.D. Fla. 2010) (worker's receipt of Form 1099-MISC from employer does not weigh in favor of independent contractor status). "Economic realities, not contractual labels, determine employment status for the remedial purposes of the FLSA." *Real v. Driscoll Strawberry Assocs., Inc.*, 603 F.2d 748, 755 (9th Cir. 1979).

The ultimate inquiry under the FLSA is whether the worker is economically dependent on the employer or truly in business for him or herself. If the worker is economically dependent on the employer, then the worker is an employee. If the worker is in business for him or herself (i.e., economically independent from the employer), then the worker is an independent contractor.

## II. The Economic Realities Factors Guide the Determination Whether the Worker Is Truly an Independent Business or Is Economically Dependent on the Employer

To help illustrate how the economic realities factors should be properly used to determine whether a worker is truly in business for him or herself, each factor is discussed in detail below. The distinction between workers who are economically dependent on employers and the narrower subset of workers who are truly independent businesspersons must not be eclipsed by a mechanical application of the economic realities test. The analysis whether the factors are met must focus on whether the worker is economically dependent on the employer or truly in business for him or herself. As a district court held in an enforcement action by the Department:

> These factors are to be considered and weighed against one another in each situation, but there is no mechanical formula for using them to arrive at the correct result. Rather, the factors are simply a tool to assist in understanding individual cases, with the ultimate goal

> of deciding whether it is economically realistic to view a relationship as one of employment or not.

*Solis v. Cascom, Inc.*, 2011 WL 10501391, at *4 (S.D. Ohio Sept. 21, 2011); *see also Scantland*, 721 F.3d at 1312 (the economic realities factors "serve as guides, [and] the overarching focus of the inquiry is economic dependence"); *Usery v. Pilgrim Equip. Co., Inc.*, 527 F.2d 1308, 1311 (5th Cir. 1976) (The economic realities factors "are aids—tools to be used to gauge the degree of dependence of alleged employees on the business with which they are connected. It is dependence that indicates employee status. Each test must be applied with that ultimate notion in mind.").

Each factor of the economic realities test is discussed below in order to highlight, using case law and examples, relevant considerations for each factor and how each suggests whether or not there is an employment relationship.

A. Is the Work an Integral Part of the Employer's Business?

The policy behind the "suffer or permit" statutory language was to bring within the scope of employment workers integrated into an employer's business. If the work performed by a worker is integral to the employer's business, it is more likely that the worker is economically dependent on the employer. *See Rutherford*, 331 U.S. at 729 (workers were employees in part because work was "part of the integrated unit of production"); *Donovan v. DialAmerica Mktg., Inc.*, 757 F.2d 1376, 1385 (3d Cir. 1985) ("workers are more likely to be 'employees' under the FLSA if they perform the primary work of the alleged employer"). A true independent contractor's work, on the other hand, is unlikely to be integral to the employer's business.[5]

Courts have found the "integral" factor to be compelling. *See, e.g., Dole v. Snell*, 875 F.2d 802, 811 (10th Cir. 1989) (holding that work performed by cake decorators "is obviously integral" to the business of selling cakes which are custom decorated); *Sec'y of Labor v. Lauritzen*, 835 F.2d 1529, 1537-38 (7th Cir. 1987) ("It does not take much of a record to demonstrate that picking the pickles is a necessary and integral part of the pickle business . . . ."). Work can be integral to a business even if the work is just one component of the business and/or is performed by hundreds or thousands of other workers. For example, a worker answering calls at a call center along with hundreds of others is performing work that is integral to the call center's business even if that

[5] Given that the "integral" factor particularly encompasses the "suffer or permit" standard and that the Supreme Court in *Rutherford* found the workers in that case to be employees, in part because they were "part of the integrated unit of production," whether the worker's work is an integral part of the employer's business should always be analyzed in misclassification cases. Although a few courts, such as the Fifth Circuit, do not include the "integral" factor in their recitation of the factors that comprise the economic realities test, they nonetheless recognize that the factors comprising the test are not exclusive. *See, e.g., Cromwell v. Driftwood Elec. Contractors, Inc.*, 348 Fed. App'x 57, 59 (5th Cir. 2009) (describing the five factors it identifies as "non-exhaustive"); *Brock v. Mr. W Fireworks, Inc.*, 814 F.2d 1042, 1043 (5th Cir. 1987) (same).

worker's work is the same as and interchangeable with many others' work. Moreover (and especially considering developments such as telework and flexible work schedules, for example), work can be integral to an employer's business even if it is performed away from the employer's premises, at the worker's home, or on the premises of the employer's customers.

**Example:**[6] For a construction company that frames residential homes, carpenters are *integral* to the employer's business because the company is in business to frame homes, and carpentry is an integral part of providing that service.

In contrast, the same construction company may contract with a software developer to create software that, among other things, assists the company in tracking its bids, scheduling projects and crews, and tracking material orders. The software developer is performing work that is *not integral* to the construction company's business, which is indicative of an independent contractor.

B. Does the Worker's Managerial Skill Affect the Worker's Opportunity for Profit or Loss?

In considering whether a worker has an opportunity for profit or loss, the focus is whether the worker's managerial skill can affect his or her profit and loss.[7] A worker in business for him or herself faces the possibility to not only make a profit, but also to experience a loss. The worker's managerial skill will often affect opportunity for profit or loss beyond the current job, such as by leading to additional business from other parties or by reducing the opportunity for future work. For example, a worker's decisions to hire others, purchase materials and equipment, advertise, rent space, and manage time tables may reflect managerial skills that will affect his or her opportunity for profit or loss beyond a current job.

On the other hand, the worker's ability to work more hours and the amount of work available from the employer have nothing to do with the worker's managerial skill and do little to separate employees from independent contractors—both of whom are likely to earn more if they work more and if there is more work available. *See Scantland*, 721 F.3d at 1316-17 ("Plaintiffs' opportunity for profit was largely limited to their ability to complete more jobs than assigned, which is analogous to an employee's ability to take on overtime work or an efficient piece-rate worker's ability to produce more pieces."). The effect on one's earnings of doing one's job well or working more hours is no different for an independent contractor than it is for an employee.

[6] The addition or alteration of any of the facts in any of the examples could change the resulting analysis. Additionally, while the examples help illustrate the discussion of several common factors of the economic realities test, no one factor is determinative of whether a worker is an employee or independent contractor.

[7] This factor is sometimes articulated as "the degree to which the worker's opportunity for profit and loss is determined by the alleged employer," *Herman v. Express Sixty-Minutes Delivery Serv., Inc.*, 161 F.3d 299, 303 (5th Cir. 1998), or simply as "the worker's opportunity for profit or loss," *Baker*, 137 F.3d at 1440. This factor should not focus, however, just on whether there is opportunity for profit or loss, but rather on whether the worker has the ability to make decisions and use his or her managerial skill and initiative to affect opportunity for profit or loss.

Those considerations are not the product of exercising managerial skill and do not demonstrate that the worker is an independent contractor. As one court said:

> There was no opportunity for increased profit or loss depending upon an alleged employee's managerial skill. While the alleged employees were free to work additional hours to increase their income, they had no decisions to make regarding routes, or acquisition of materials, or any facet normally associated with the operation of an independent business.

*Cascom*, 2011 WL 10501391, at *6; *see also Scantland*, 721 F.3d at 1317 ("An individual's ability to earn more by being more technically proficient is unrelated to an individual's ability to earn or lose profit via his managerial skill, and it does not indicate that he operates his own business."); *Martin v. Selker Bros., Inc.*, 949 F.2d 1286, 1294 (3d Cir. 1991) (opportunity for profit or loss must depend on managerial skills to indicate independent contractor status); *Snell*, 875 F.2d at 810 (cake decorators' "earnings did not depend upon their judgment or initiative, but on the [employer's] need for their work").[8]

Consistent with determining whether the worker is in business for him or herself, it is important not to overlook whether there is an opportunity for loss, as a worker truly in business for him or herself faces the possibility of experiencing a loss. *See, e.g., Snell*, 875 F.2d at 810 (possibility of loss is a risk usually associated with independent contractor status, but there was no way for cake decorators to experience a loss, and possible reduction in earnings was not the same as a loss); *Lauritzen*, 835 F.2d at 1536 (migrant farm workers had no possibility for loss of investment, only loss of wages, indicating that they were employees). In sum, in order to inform the determination of whether the worker is in business for him or herself, this factor should not focus on the worker's ability to work more hours, but rather on whether the worker exercises managerial skills and whether those skills affect the worker's opportunity for both profit and loss.

**Example:** A worker provides cleaning services for corporate clients. The worker performs assignments only as determined by a cleaning company; he does not independently schedule assignments, solicit additional work from other clients, advertise his services, or endeavor to reduce costs. The worker regularly agrees to work additional hours at any time in order to earn more. In this scenario, the worker *does not exercise managerial skill* that affects his profit or loss. Rather,

[8] In *Chao v. Mid-Atlantic Installation Servs., Inc.*, 16 Fed. App'x 104, 106-07 (4th Cir. 2001), the Fourth Circuit identified "the business acumen with which the Installer makes his required capital investments in tools, equipment, and a truck" and the "decision whether to hire his own employees or to work alone" as indicative of the managerial skill that suggests independent contractor status. The court also identified the workers' skill in meeting technical specifications and their ability to control earnings by working more or fewer hours as indicative of managerial skill. *Id.; see also Express Sixty-Minutes*, 161 F.3d at 304 (relying on workers' "ability to choose how much they wanted to work" as indicative of managerial skill). These latter considerations do not helpfully distinguish between workers who are in business for themselves and those who are economically dependent on the employer.

his earnings may fluctuate based on the work available and his willingness to work more. This lack of managerial skill is indicative of an employment relationship between the worker and the cleaning company.

In contrast, a worker provides cleaning services for corporate clients, produces advertising, negotiates contracts, decides which jobs to perform and when to perform them, decides to hire helpers to assist with the work, and recruits new clients. This worker *exercises managerial skill* that affects his opportunity for profit and loss, which is indicative of an independent contractor.

C. How Does the Worker's Relative Investment Compare to the Employer's Investment?

Courts also consider the nature and extent of the relative investments of the employer and the worker in determining whether the worker is an independent contractor in business for him or herself. The worker should make some investment (and therefore undertake at least some risk for a loss) in order for there to be an indication that he or she is an independent business. An independent contractor typically makes investments that support a business as a business beyond any particular job. The investment of a true independent contractor might, for example, further the business's capacity to expand, reduce its cost structure, or extend the reach of the independent contractor's market.

Even if the worker has made an investment, it should not be considered in isolation; it is the relative investments that matter. Looking not just to the nature of the investment, but also comparing the worker's investment to the employer's investment helps determine whether the worker is an independent business. If so, the worker's investment should not be relatively minor compared with that of the employer. If the worker's investment is relatively minor, that suggests that the worker and the employer are not on similar footings and that the worker may be economically dependent on the employer.

For example, investing in tools and equipment is not necessarily a business investment or a capital expenditure that indicates that the worker is an independent contractor. *See Snell*, 875 F.2d at 810 (citing cases); *Lauritzen*, 835 F.2d at 1537. Instead, the tools and equipment may simply be necessary to perform the specific work for the employer. Even if the investment is possibly a business investment, the worker's investment must be significant in nature and magnitude relative to the employer's investment in its overall business to indicate that the worker is an independent businessperson. The Tenth Circuit determined, for example, that rig welders' investments in equipped trucks costing between $35,000 and $40,000 did not indicate that the rig welders were independent contractors when compared to the employer's investment in its business. *See Baker*, 137 F.3d at 1442 (comparing rig welders' investment to employer's "hundreds of thousands of dollars of equipment at each work site"); *see also Snell*, 875 F.2d at 810-11 (comparing cake decorators' $400 investment in their tools to employers' business investments, including paying for rent, advertising, operating expenses, and labor, in addition to supplies and decorating equipment); *Lauritzen*, 835 F.2d at 1537 (reasoning that where workers provided their own gloves, and the employer provided the farm equipment, land, seed, fertilizers, and living quarters, their work was not independent of the employer); *Hopkins*, 545 F.3d at 344 (comparing each worker's individual investment to employer's overall investment in the business); *Real v. Driscoll Strawberry Assocs., Inc.*, 603 F.2d 748, 755 (9th Cir. 1979) (strawberry growers' investment in light equipment, including hoes, shovels, and picking carts was "minimal in comparison" with employer's total investment in land and heavy machinery).

An analysis of the workers' investment, even if that investment is substantial, without comparing it to the employer's investment is not faithful to the ultimate determination of whether the worker is truly an independent business.[9] Moreover, an analysis that compares the worker's investment to the employer's investment—but only to the employer's investment in the particular job performed by the worker—likewise disregards the ultimate determination by examining only a piece of the employer's business for the comparison.

**Example**: A worker providing cleaning services for a cleaning company is issued a Form 1099-MISC each year and signs a contract stating that she is an independent contractor. The company provides insurance, a vehicle to use, and all equipment and supplies for the worker. The company invests in advertising and finding clients. The worker occasionally brings her own preferred cleaning supplies to certain jobs. *In this scenario, the relative investment of the worker as compared to the employer's investment is indicative of an employment relationship between the worker and the cleaning company.* The worker's investment in cleaning supplies does little to further a business beyond that particular job.

A worker providing cleaning services receives referrals and sometimes works for a local cleaning company. The worker invests in a vehicle that is not suitable for personal use and uses it to travel to various worksites. The worker rents her own space to store the vehicle and materials. The worker also advertises and markets her services and hires a helper for larger jobs. She regularly (as opposed to on a job-by-job basis) purchases material and equipment to provide cleaning services and brings her own equipment (vacuum, mop, broom, etc.) and cleaning supplies to each worksite. Her level of investments is similar to the investments of the local cleaning company for whom she sometimes works. *These types of investments may be indicative of an independent contractor*.

D. Does the Work Performed Require Special Skill and Initiative?

A worker's business skills, judgment, and initiative, not his or her technical skills, will aid in determining whether the worker is economically independent. "[T]he fact that workers are skilled is not itself indicative of independent contractor status." *Superior Care*, 840 F.2d at 1060. Even specialized skills do not indicate that workers are in business for themselves, especially if those skills are technical and used to perform the work. *See id*. Accordingly, the conclusion that the skills of installing cable are indicative of independent contractor status because the skills are "akin to those of carpenters, construction workers, and electricians, who

[9] *Cf. Mid-Atlantic Installation*, 16 Fed. App'x at 107 (analyzing workers' investment without comparing it to employer's investment); *Freund v. Hi-Tech Satellite, Inc.*, 185 Fed. App'x 782, 783-84 (11th Cir. 2006) (same).

are usually considered independent contractors," *Mid-Atlantic Installation*, 16 Fed. App'x at 107, overlooks whether the worker is exercising business skills, judgment, or initiative. The technical skills of cable installers, carpenters, construction workers, and electricians, for example, even assuming that they are special,[10] are not themselves indicative of any independence or business initiative. *See Selker Bros.*, 949 F.2d at 1295 ("the use of special skills is not itself indicative of independent contractor status, especially if the workers do not use those skills in any independent way"); *Superior Care*, 840 F.2d at 1060 (for skills to be indicative of independent contractor status, they should be used in some independent way, such as demonstrating business-like initiative); *Express Sixty-Minutes*, 161 F.3d at 305 (efficiency in performing work is not initiative indicative of independent contractor status); *Lauritzen*, 835 F.2d at 1537 ("Skills are not the monopoly of independent contractors."). Only carpenters, construction workers, electricians, and other workers who operate as independent businesses, as opposed to being economically dependent on their employer, are independent contractors.

**<u>Example</u>**: A highly skilled carpenter provides carpentry services for a construction firm; however, such skills are not exercised in an independent manner. For example, the carpenter does not make any independent judgments at the job site beyond the work that he is doing for that job; he does not determine the sequence of work, order additional materials, or think about bidding the next job, but rather is told what work to perform where. In this scenario, the carpenter, although highly-skilled technically, is *not demonstrating the skill and initiative of an independent contractor* (such as managerial and business skills). He is simply providing his skilled labor.

In contrast, a highly skilled carpenter who provides a specialized service for a variety of area construction companies, for example, custom, handcrafted cabinets that are made-to-order, may be demonstrating the *skill and initiative of an independent contractor* if the carpenter markets his services, determines when to order materials and the quantity of materials to order, and determines which orders to fill.

E. <u>Is the Relationship between the Worker and the Employer Permanent or Indefinite?</u>

Permanency or indefiniteness in the worker's relationship with the employer suggests that the worker is an employee. After all, a worker who is truly in business for him or herself will

[10] A district court determined that the cable installation at issue in that case "did not require a special skill" and could be learned by workers with no experience in the field after six weeks of training. *Cascom*, 2011 WL 10501391, at *6; *see also Scantland*, 721 F.3d at 1318 (cable installers admitted that they were skilled workers; however, "[t]he meaningfulness of this skill as indicating that [they] were in business for themselves or economically independent . . . is undermined by the fact that [the employer] provided most [of them] with their skills"); *Keller v. Miri Microsystems LLC*, 781 F.3d 799, 809-810 (6th Cir. 2015) (denying summary judgment and contrasting carpenters, who have "unique skill, craftsmanship, and artistic flourish," with cable technicians who do not need "unique skills" but rather are selected on the basis of availability and location).

eschew a permanent or indefinite relationship with an employer and the dependence that comes with such permanence or indefiniteness. Most workers are engaged on a permanent or indefinite basis (for example, the typical at-will employee). Even if the working relationship lasts weeks or months instead of years, there is likely some permanence or indefiniteness to it as compared to an independent contractor, who typically works one project for an employer and does not necessarily work continuously or repeatedly for an employer. *See, e.g., DialAmerica Mktg.*, 757 F.2d at 1384-85 (correcting district court for ignoring fact that workers worked continuously for the employer and that such evidence indicates that workers were employees); *Cascom*, 2011 WL 10501391, at *6 (workers who "worked until they quit or were terminated" had relationship "similar to an at-will employment arrangement").

However, a lack of permanence or indefiniteness does not automatically suggest an independent contractor relationship, and the reason for the lack of permanence or indefiniteness should be carefully reviewed to determine if the reason is indicative of the worker's running an independent business. As the Second Circuit noted, neither working for other employers nor not relying on the employer as his or her primary source of income transform the worker into the employer's independent contractor. *See Superior Care*, 840 F.2d at 1060. The key is whether the lack of permanence or indefiniteness is due to "operational characteristics intrinsic to the industry" (for example, employers who hire part-time workers or use staffing agencies[11]) or the worker's "own business initiative." *Id.* at 1060-61 ("the fact that these nurses are a transient work force reflects the nature of their profession and not their success in marketing their skills independently"); *see also Mr. W Fireworks*, 814 F.2d at 1054 ("We thus hold that when an industry is seasonal, the proper test for determining 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."). A worker's lack of a permanent or indefinite relationship with an employer is indicative of independent contractor status if it results from the worker's own independent business initiative. *See Superior Care*, 840 F.2d at 1060-61.

**Example**:[12] An editor has worked for an established publishing house for several years. Her edits are completed in accordance with the publishing house's specifications, using its software. She only edits books provided by the publishing house. This

[11] *See, e.g., Solis v. A+ Nursetemps, Inc.*, 2013 WL 1395863, at *7 (M.D. Fla. Apr. 5, 2013) (holding that nurses were employees of a temporary health care staffing agency; although nurses "enjoy[ed] a degree of flexibility . . . not shared by many in the work force," had "an enhanced ability to 'moonlight' by working for more than one [staffing] agency at a time," and had some flexibility in choosing "when and where to make themselves available for work," the court concluded that when the nurses were working on assignment for the staffing agency they were, during those work weeks, its employees).

[12] This factor helps illustrate how no one factor alone is determinative of the economic realities of the relationship between a worker and an employer and how it can be difficult to isolate one factor. Here, the example necessarily includes relevant facts beyond just the permanence or indefiniteness of the editors' relationships with the publishing houses to illustrate the existence, or not, of an employment relationship.

> scenario *indicates a permanence to the relationship* between the editor and the publishing house that is indicative of an employment relationship.
>
> Another editor has worked intermittently with fifteen different publishing houses over the past several years. She markets her services to numerous publishing houses. She negotiates rates for each editing job and turns down work for any reason, including because she is too busy with other editing jobs. This *lack of permanence* with one publishing house is indicative of an independent contractor relationship.

F. What is the Nature and Degree of the Employer's Control?

As with the other economic realities factors, the employer's control should be analyzed in light of the ultimate determination whether the worker is economically dependent on the employer or truly an independent businessperson. The worker must control meaningful aspects of the work performed such that it is possible to view the worker as a person conducting his or her own business. *See Scantland*, 721 F.3d at 1313 ("'Control is only significant when it shows an individual exerts such a control over a meaningful part of the business that she stands as a separate economic entity.'") (quoting *Pilgrim Equip.*, 527 F.2d at 1312-13); *Baker*, 137 F.3d at 1441. And the worker's control over meaningful aspects of the work must be more than theoretical—the worker must actually exercise it. *See, e.g., Snell*, 875 F.2d at 808; *Mr. W Fireworks*, 814 F.2d at 1047 ("it is not what the operators *could* have done that counts, but as a matter of economic reality what they actually *do* that is dispositive") (emphases in original).

For example, an employer's lack of control over workers is not particularly telling if the workers work from home or offsite. As the Third Circuit explained in *DialAmerica Marketing*, the fact that the workers could control the hours during which they worked and that they were subject to little direct supervision was unsurprising given that such facts are typical of homeworkers and thus largely insignificant in determining their status. *See* 757 F.2d at 1384 ("The district court therefore misapplied and overemphasized the right-to-control factor in its analysis."); *see also Superior Care*, 840 F.2d at 1060 ("An employer does not need to look over his workers' shoulders every day in order to exercise control."); *Antenor*, 88 F.3d at 933 (The "courts have found economic dependence under a multitude of circumstances where the alleged employer exercised little or no control or supervision over the putative employees."). Moreover, workers' control over the hours when they work is not indicative of independent contractor status. *See, e.g., Snell*, 875 F.2d at 806 ("Of course, flexibility in work schedules is common to many businesses and is not significant in and of itself."); *Doty v. Elias*, 733 F.2d 720, 723 (10th Cir. 1984) ("A relatively flexible work schedule alone, however, does not make an individual an independent contractor rather than an employee.").

Technological advances and enhanced monitoring mechanisms may encourage companies to engage workers not as employees yet maintain stringent control over aspects of the workers' jobs, from their schedules, to the way that they dress, to the tasks that they carry out. Some employers assert that the control that they exercise over workers is due to the nature of their business, regulatory requirements, or the desire to ensure that their customers are satisfied.

However, control exercised over a worker, even for any or all of those reasons, still indicates that the worker is an employee. As the Eleventh Circuit explained:

> [The employer] also argues that its quality control measures and regulation of schedules stemmed from "the nature of the business" and are therefore not the type of control that is relevant to the economic dependence inquiry. We disagree. The economic reality inquiry requires us to examine the nature and degree of the alleged employer's control, not why the alleged employer exercised such control. Business needs cannot immunize employers from the FLSA's requirements. If the nature of a business requires a company to exert control over workers to the extent that [the employer] has allegedly done, then that company must hire employees, not independent contractors.

*Scantland*, 721 F.3d at 1316. Thus, the nature and degree of the employer's control must be examined as part of determining the ultimate question whether the worker is economically dependent on the employer.

Finally, the "control" factor should not play an oversized role in the analysis of whether a worker is an employee or an independent contractor. All possibly relevant factors should be considered, and cases must not be evaluated based on the control factor alone. *See, e.g., Superior Care, Inc.*, 840 F.2d at 1059 ("No one of these factors is dispositive; rather, the test is based on a totality of the circumstances."). As discussed above, the FLSA's statutory definitions (including "suffer or permit") rejected the common law control test for determining employment that was prevalent at the time. *See Walling*, 330 U.S. at 150-51; *Darden*, 503 U.S. at 326. Indeed, the FLSA covers workers of an employer even if the employer does not exercise the requisite control over the workers, assuming the workers are economically dependent on the employer. The control factor should not overtake the other factors of the economic realities test, and like the other factors, it should be analyzed in the context of ultimately determining whether the worker is economically dependent on the employer or an independent business.

**<u>Example</u>**: A registered nurse who provides skilled nursing care in nursing homes is listed with Beta Nurse Registry in order to be matched with clients. The registry interviewed the nurse prior to her joining the registry, and also required the nurse to undergo a multi-day training presented by Beta. Beta sends the nurse a listing each week with potential clients and requires the nurse to fill out a form with Beta prior to contacting any clients. Beta also requires that the nurse adhere to a certain wage range and the nurse cannot provide care during any weekend hours. The nurse must inform Beta if she is hired by a client and must contact Beta if she will miss scheduled work with any client. In this scenario, *the degree of control exercised by the registry is indicative of an employment relationship*.

Another registered nurse who provides skilled nursing care in nursing homes is listed with Jones Nurse Registry in order to be matched with clients. The registry sends the nurse a listing each week with potential clients. The nurse is free to call as many or as few potential clients as she wishes and to work for as many or as few as she wishes; the nurse also negotiates her own wage rate and schedule with the client. In this scenario, *the degree of control exercised by the registry is not indicative of an employment relationship.*

## III. Conclusion

In sum, most workers are employees under the FLSA's broad definitions. The very broad definition of employment under the FLSA as "to suffer or permit to work" and the Act's intended expansive coverage for workers must be considered when applying the economic realities factors to determine whether a worker is an employee or an independent contractor. The factors should not be analyzed mechanically or in a vacuum, and no single factor, including control, should be over-emphasized. Instead, each factor should be considered in light of the ultimate determination of whether the worker is really in business for him or herself (and thus is an independent contractor) or is economically dependent on the employer (and thus is its employee). The factors should be used as guides to answer that ultimate question of economic dependence. The correct classification of workers as employees or independent contractors has critical implications for the legal protections that workers receive, particularly when misclassification occurs in industries employing low wage workers.

***Contingent Workers: What the Federal and State Governments Have To Say About It***

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## I. Introduction

The issue of employee misclassification has reached a fever-pitch with the IRS and DOL teaming up to stop abuse of the system and states across the country entering agreements with the DOL. While the legal issues can seem complex, the issue seems to boil down to a simple point: Does the employer have the right to control the work of the third-party employee? Misclassification happens because of lack of knowledge and mistake. However, many misclassifications appear to be the result of (1) employers intentionally classifying workers as independent contractors to avoid paying overtime and taxes, and (2) employees who are desperate to increase immediate compensation with the intent to avoid taxes. Federal and state governments are scurrying to eliminate the cost of employee misclassification. On September 22, 2015, the USDOL announced that more than $39.3 million in federal grants were awarded that will enhance unemployment insurance programs in 45 states, including District of Columbia, and Puerto Rico, and reduce the misclassification of employees as independent contractors.

## II. Memorandum of Understanding

On September 19, 2011 the Internal Revenue Service and the US Department of Labor entered a Memorandum of Understanding (MOU) with respect to a "joint initiative to improve compliance with laws and regulations administered by the IRS and DOL." The purpose of the MOU was to share information and to otherwise work collaboratively to reduce incidents of misclassification of employees as independent contractors. The MOU set out specific objectives including an intent to expand the IRS-DOL partnership launched in the Questionable Employment Tax Practices program. The other objectives were to increase compliance with tax requirements, reduce fraudulent filings, reduce misclassifications and to work together to educate employers and workers. A copy of the MOU can be found at the DOL website. (www.dol.gov/whd/workers/MOU/irs/pdf).

## III. JOINT INITIATIVES BETWEEN DOL AND THE INDIVIDUAL STATES WITH A GLANCE AT 2015 ACTION

| | AGREEMENT WITH THE USDOL | | |
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| **Alabama** | Signed: October 2, 2014<br>Amended: March 26, 2015<br>Expires: October 2, 2017 | AL HB 497 (5/22/12) Amends existing law relating to the exemption from workers' compensation coverage for certain independent contractors; qualifies sports officials as independent contractors; exempts sports officials from workers' compensation coverage. | 8/08/15: Fitzhugh Contracting LLC, a logging and trucking contractor, agreed to pay 63 employees $112,735 in back wages and damages arising from a DOL investigation finding 46 employees were misclassified as independent contractors. |
| **Alaska** | Signed: August 13, 2015<br>Expires: August 13, 2018 | | 9/03/15: Uber Technologies, Inc. and Rasier, LLC have entered into a settlement agreement to pay $77,925 to Alaska Workers' Compensation Benefit Guaranty Fund and stop operating in Alaska unless or until they comply with state law. Lawsuits alleged that Uber (an on-demand ride-sharing firm) was misclassifying driver employees as independent contractors contrary to the Alaska Workers' Compensation Act. Lawsuits were filed in PA, CA, and NY. |
| **Arizona** | No Agreement | AZ HB 2150 (2015) Relates to unemployment insurance, independent contractors ... indications of control by the employing unit include controlling the individual's hours of work, location of work, right to perform services for others, tools, equipment, materials, | 10/8/15: Hope Medical Transportation has agreed to pay over $35,000 in back wages and penalties arising from a USDOL investigation wherein it was alleged that Hope failed to keep accurate records and misclassified most of its drivers as independent contractors.<br>4/23/15: CSG Workforce Partners, Universal Contracting LLC, and Arizona Tract/Arizona CLA have entered into a consent order yielding $700,000 for over 1,000 allegedly wrongly classified construction workers arising from a five-year USDOL investigation. Construction workers were required to become members/owners of LLCs, stripping them of federal and state protections. The construction workers were building houses in UT and AZ. *Perez v. Universal* |

| | AGREEMENT WITH THE USDOL | | |
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| | | expenses, use of other workers and other indicia of employment; requires notification; provides for determinations of contribution rate redetermination or denial. | *Contracting LLC et al.*, 2:13-cv-253-DS; *Perez v Arizona CLA LLC*, et al., 2:15-cv-00461-JAT |
| **Arkansas** | No Agreement | AR SB 802 (4/12/13) provides that an owner-operator that provides a commercial motor vehicle and the services of one or more drivers to a motor carrier under a written contract, and each driver so provided, is not an employee of the motor carrier but is an independent contractor of the motor carrier; provides that the carrier is not liable for any required compensation; authorizes certain owner-operators to elect to secure Worker's Compensation coverage. | |
| **California** | Signed: December 21, 2011<br>Expires: December 21, 2014 | Bill No. AB 202 (eff. 1/2016) Cheerleaders utilized by a professional sports team deemed an employee.<br><br>AB 621 (10/10/15) offers | 10/19/15: Greenstone Materials, Inc., agreed to pay $149,000 in back wages and damages for 40 workers arising from a USDOL investigation wherein it found that Greenstone started all of its new hires as 1099 independent contractors during a probationary period of up to three months and were paid straight time rates for overtime hours.<br><br>10/15/15: FedEx Ground settled a class action for $228 million. |

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| | | amnesty for motor carrier companies using independent contractors “if the motor carrier enters into a settlement agreement with the Labor Commissioner, with the cooperation and consent of the Employment Development Dept., prior to January 1, 2017 ...”<br><br>CA SB 459 (10/09/11) Prohibits willful misclassification of individuals as independent contractors, charging those who have been mischaracterized as independent contractors a fee, or making deductions from wages where the acts would have violated the law if the individuals had not been mischaracterized. Provides for damages and disciplinary actions on persons and employers. Requires violator notification to the Contractor's License Board. Relates to complaints. Provides for | Allegations against FedEx Ground drivers in California included violations under federal and state law, claims for reimbursement of business expenses, unpaid overtime, failure to provide meal and rest periods, reimbursement of deductions in pay, and non-payment of termination pay, plus attorneys’ fees and litigation costs. *Alexander v. FedEx Ground Package System,* 3:05-cv-00038-E (CAND).<br>9/01/15: The federal district court ruled the following concerning Uber drivers: Claims asserted by the drivers that they are entitled to the full amount of tips received and that Uber improperly retained a portion of the gratuities could be maintained as a class action. A claim that the drivers must be reimbursed by Uber for all necessary expenses like car maintenance and fuel, was not permitted by the court to proceed as a class action. The court also limited the scope of which drivers may be part of the class. *O’Connor v. Uber Technologies, Inc.*, 3:13-cv-03826 (CAND).<br>9/29/15: A judge certified a class of 43 freelance content producers who worked at Prometheus from January 2010 through the present. The primary allegation is that the freelancers were misclassified as independent contractors and denied proper payment of overtime.<br>8/11/15: Seven residential care facilities owned by Ador Ancheta will pay over $203,000 in back wages and damages arising from a USDOL investigation wherein it was discovered that allegedly (1) 53 workers were not paid overtime, (2) the employer failed to maintain accurate records, and (3) misclassified some workers as independent contractors.<br>8/08/15: Two significant rulings were entered in California courts requiring two companies to pay nearly $8 million in back pay and damages. National Consolidated Couriers agreed to a $5 million judgment for allegedly misclassifying over 600 drivers as independent contractors. Stanford Yellow Taxi Cab, Inc., also allegedly misclassified drivers and was ordered to stop threatening and intimidating drivers cooperating with the investigation and was forced to pay nearly $3 million in back wages to dozens of drivers. It was |

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| | | joint and several liability in certain situations. | found that Stanford drivers were required to be on the job six days per week for 12-hour shifts, but the company did not compensate them for all those hours. *Perez v. National Consolidated Couriers, Inc.,* 3:15-cv-1026 and 3:15-cv-3224. *Perez v Stanford Yellow Taxi Cab, Inc*., 5:14-cv-03983.<br>7/15/15: Nationwide Courier Company agreed to a consent judgment of $5 million for alleged unpaid minimum wages and overtime payable to 600 drivers and damages.<br>6/01/15: The California Court of Appeal ruled that "contrary to the trial court's interpretation, section 226.8 is not limited to employers who make the misclassification decision, but also extends to any employer who is aware that a co-employer has willfully misclassified their joint 320 employees and fails to remedy the misclassification." *Noe v. Superior Court of Los Angeles,* No. B259570 (Cal. Ct. of App. 2d App. Dist. June 1, 2015).<br>5/06/15: Shippers Transport Express, Inc. and SSA Marine, Inc. settled a class action for $11 million brought by Los Angeles port truckers alleging they were misclassified as independent contractors. *Taylor v. Shippers Transport Express, Inc.,* No. 2:13-cv-02092 (CACD).<br>3/16/15: Macy's West Stores, Inc. agreed to pay $4 million to settle a class action misclassification lawsuit by over 600 truck drivers and their helpers. The plaintiffs alleged that although the drivers signed independent contractor agreements with the logistics management company, the relationship was heavily regulated by Macy's and the logistics company through work-related directives and restrictions, including allegations that the drivers/helpers were required to display Macy's logo on their trucks and had to wear Macy's uniforms, could not set their own delivery schedules, had to leave the trucks at Macy's site at the end of the day, and had to go through the process of role-playing where Macy's employees evaluated whether the drivers/helpers met Macy's standards and expectations of delivery and customer service. *Fuentes v. Macy's West Stores Inc.*, 2:14-cv-00790 (CACD). |

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| **Colorado** | Signed: December 5, 2011<br>Renewed: December 5, 2014<br>Expires: December 5, 2017 | | |
| **Connecticut** | Signed: September 19, 2011<br>Renewed: November 20, 2014<br>Expires: November 20, 2017 | CT HB 6154 (6/24/13) creates an exception in the statutes for service performed by the operator of a motor vehicle transporting property for compensation pursuant to an agreement with a contracting party, provided certain conditions are met, including conditions concerning gross vehicle weight, lease arrangements and compensation.<br><br>CT HB 6370 (5/24/11) requires the Labor Commissioner to submit a plan to consolidate and promote efficiency of its investigative and enforcement provisions; requires the plan to include ... employee classification, .... | 9/18/15: LaserShip, Inc., objected to a subpoena served on it by USDOL on 2/11/15. The Court upheld the subpoena and required LaserShip to pay the DOL reasonable costs and attorneys' fees. *Perez v Lasership, Inc.*, 3:15-mc-00031. |
| **Delaware** | No Agreement | DE HB 55 (6/06/13) clarifies parties to a franchise agreement are not within the definition under the Wage Payment and Collection | |

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| | | Act.<br><br>DE HB 222 (7/12/12) requires the DOL to publish, on its website, the names of employers who have violated the Workplace Fraud Act by misclassifying an employee as an independent contractor or otherwise. | |
| **District of Columbia** | No Agreement | Wage Theft Prevention Amendment Act (2/26/15) increases penalties for violations of wage and hour laws.<br><br>Workplace Fraud Act (Bill No 19-169, eff. 4/27/13) Provides for a penalty for an employer who misclassifies an employee as an independent contractor; allows the employee to seek up to treble damages for lost wages and benefits; requires an employer to pay restitution, be subject to a stop-work order or debarment, and come into compliance under the law; requires the employer to provide notice to each employee | |

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| | | of their status as an independent contractor and the implications of such status, and to maintain records of independent contractors | |
| **Florida** | Signed: January 13, 2015<br>Expires: January 13, 2018 | FL HB 1179 (6/13/14) provides that registered nurses, licensed practical nurses, certified nursing assistants, companions, homemakers and home health aides are independent contractors and not employees of the registries that referred them and is not responsible for monitoring and training; requires recordkeeping; exempts Medicare and Medicaid agencies .<br><br>FL HB 311 (5/31/11) provides a definition for the term independent contractor; exempts an individual engaging in or managing a business in an individual capacity as an employee from requirements related to local business taxes; specifies that an independent contractor is not employee; prohibits local governing | 11/18/14: Federal Verification Co., Inc., dba GSA Applications had to pay $281,000 in back wages and damages arising from a USDOL investigation wherein it alleged that sales people were misclassified as independent contractors and paid wages less than minimum wage and some employees were paid commissions that did not equal minimum wage.<br>7/07/15: Caring First Inc. and others were sued by the USDOL alleging misclassification of employees, including nurses, as independent contractors, paying them a flat hourly rate regardless of the number of hours worked. *Perez v. Caring First, Inc., et al.,* 8:15-cv-1590-(FLMD).<br>6/26/15: J.W. Lee, Inc. dba Scarlett's Cabaret, a chain of adult nightclubs, agreed to pay $6 million to settle an independent contractor misclassification class action on behalf of 4,700 current and former exotic entertainers. Dancers from Florida and Ohio clubs claimed that between 2009 and 2015 their only form of compensation was tips. Clubs had the power to hire and fire; dancers were told what to wear; were required to sell the club's promotional products; required to pay "house fees"; and set the schedules. *Encarnacion v. J.W. Lee, Inc., d/b/a Scarlett's Cabaret,* 14-61927(S.D. Fla. June 26, 2015). |

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| | | authority from holding an exempt employee liable for the failure of principal or employer to comply with certain obligations related to local business tax. | |
| **Georgia** | No Agreement | HB 500 (passed by HR on 3/9/15), awaiting action in the state Senate, proposes two exceptions to being deemed an employee and that the DOL create a web-based reporting system for IC misclassification instances and that it follow-up and investigate the reporting. | 9/24/15: Giovanni DiPalma, an Atlanta restauranteur, and Antico Foods entered into a consent order on 10/17/14 to pay $330,000 in back wages and damages, which includes a five-year injunction from terminating and threatening workers. USDOL began investigating DiPalma in July 2014 for allegedly improperly classifying kitchen staff as exempt and misclassifying an administrative assistant as an independent contractor. *Perez v Antico Foods, LLC,* 14-cv-03143-SCJ and 15-cv-0334-TCG<br>8/11/15: Wang's Partner Inc. dba Hibachi Grill and Supreme Buffet was ordered to pay nearly $2 million in back wages and damages to 84 restaurant employees allegedly misclassified as independent contractors. *Perez v. Wang*, 1:13-04162 (GAND).<br>7/15/15: Pegasso Construction & Floor Covering LLC agreed to pay $135,819 in back wages arising from a DOL investigation finding that the firm misclassified all of its workers as independent contractors and it allegedly violated the DBRA and CWHSSA [work was at Fort Gordon and was federally financed] by not accurately completing the required certified payrolls.<br>5/14/15: The Great American Dream dba Pin Ups Nightclub, a strip club, was granted partial summary judgment by a federal district court finding that the Club did not willfully misclassify the dancers as independent contractors and that it relied on the advice of accountants, consultants, attorneys and business managers and industry practice. However, the court held exotic dancers were employees. *Stevenson v. The Great American Dream, Inc.,* 1:12-cv-03359 (GAND). |
| **Hawaii** | Signed: July 20, 2011 | HI SB 1219 (passed with | |

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| | Renewed: September 2, 2015<br>Expires: September 2, 2018 | amendments on 3/27/15) would clarify Hawaii's employment security law for independent contractors and includes 20 factors to be used as guidelines when determining whether a worker is an independent contractor. (Similar HB1213 is pending.) | |
| **Idaho** | Signed: August 6, 2015<br>Expires: August 6, 2015 | | |
| **Illinois** | Signed: September 28, 2011<br>Renewed: October 23, 2014<br>Expires: October 23, 2017 | IL HB 923 (7/23/13) (Public Act 98-105, amended by § 43) amends the Employee Classification Act; requires contractors for which construction services are performed by an individual, sole proprietor, or partnership to report all payments made to those entities if the recipient of the payment is not classified as an employee; provides that contractors who violate the reporting provisions may be subject to civil penalties and debarment; provides that the reporting requirements do not | 6/15/15: Illinois college towns are current targets of USDOL investigations of restaurants, hotels and resorts along with other college towns such as Bloomington, IN, and Ames, IA.<br>8/5/14: Super Maid was ordered to pay $184,505 in back wages and damages to 55 employees arising from investigations by the USDOL for allegedly misclassifying employees as independent contractors. Maids were paid a flat rate regardless of time spent traveling and working. *Solis v Super Maid, LLC, et al.*, 1:11-cv-07485. |

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| | | apply to specified bidders. | |
| **Indiana** | No Agreement | | 6/15/15: College town Bloomington, IN, is a current target of USDOL investigations of restaurants, hotels and resorts. |
| **Iowa** | Signed: January 17, 2013<br>Expires: January 17, 2016 | | 6/15/15: College town Ames, IA, is a current target of USDOL investigations of restaurants, hotels and resorts. |
| **Kansas** | No Agreement | | 7/08/15: The Seventh Circuit held that Plaintiff FedEx drivers were employees of FedEx for the purposes of KWPA. *Craig v. FedEx Ground Package Sys., Inc.*, No. 10-3115 (6th Cir). |
| **Kentucky** | Signed: July 15, 2015<br>Expires: July 15, 2018 | HB 256 (BR 819) provides, among other things misclassification problems, definitions, determination of misclassified workers.<br><br>KY SB 105 (4/2/14) deletes newspaper carriers from being considered employees of independent news agencies for workers' compensation purposes. | 5/08/15: Shivam Hospitality LLC dba Super 8 has agreed, pursuant to a consent order, to pay $119,434 to 43 employees, to be under permanent injunction to ensure FLSA compliance, and has promised not to violate anti-retaliation provisions. The DOL investigation found (and later alleged in a lawsuit) that Shivam deliberately misclassified low-wage workers as independent contractors. *Perez v Shivam Hospitality, LLC, et al.*, 2:15-cv-00066-DLB-CJS. |
| **Louisiana** | Signed: February 23, 2012<br>Renewed: February 23, 2015<br>Expires: February 23, 2018 | LA SB 472 (2015) prohibits certain employees of staffing services from being classified as independent contractors by employers .... | |
| **Maine** | No Agreement | ME HB 960 (4/18/12) standardizes the definition of independent contractor for employment security law and workers' compensation law; | |

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| | | states penalties for the misclassification of a worker as an independent contractor; requires two reports on the implementation of the new definition.<br><br>ME SB 95 (5/9/11) excepts a private investigator from the definition of employment in the Employment Security Law if there is a written contract between the parties, the private investigator operates independently, compensation for services is negotiated and the party requesting services furnishes neither equipment nor the place of employment to the private investigator.<br><br>ME SB 193 (5/9/11) Excludes licensed tattoo artists who operate within an establishment owned by another under a booth rental agreement or other rental agreement from the definition of | |

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| | | employment for purposes of the unemployment compensation law.<br><br>ME SB 332 (5/31/11) establishes a set of factors to determine whether an individual engaged in the business of freight transportation or courier and messenger services is an employee or an independent contractor for purposes of the workers' compensation laws.<br><br>ME SB 437 (6/10/11) modifies the laws regarding status as an independent contractor; makes changes to provisions concerning unemployment compensation; directs the Commissioner of Labor to ... develop an employment test to be used ... to determine whether a person is an employee or independent contractor. | |
| **Maryland** | Signed: September 19, 2011<br>Renewed: October 17, 2014<br>Expires: October 17, 2017 | MD SB 1057 (5/02/13) requires a health care staff agency to be | 6/30/15: Direct TV won two lawsuits brought by satellite installers. The installers did not show or present evidence that DirecTV has the power to hire and fire, determine rate and method |

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| | | licensed by the Office of Health Care Quality in the Department of Health and Mental Hygiene before referring health care practitioners to a health care facility as independent contractors for temporary health care services; includes nurse anesthetists, physicians, podiatrists and pharmacists.<br><br>MD HB 1364 and SB 272 (5/2/12) establishes an exception for an employer that produces specified documents for inspection to the presumption that an employer-employee relationship exists for purposes of the Workplace Fraud Act; authorizes an employer to provide copies of records; alters the number of days within which an employer is required to produce records; alters the requirement that a public body withhold funds from an employer; relates to violations | of pay, or that it maintained employment records. *Hall v. DirecTV,* No. 1:14-cv-02355 (D. Md. June 30, 2015); and *Lewis v. DirecTV,* No. 1:14-cv-03261 (D. Md. June 30, 2015). |

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| | | under the act. | |
| **Massachusetts** | Signed: September 19, 2011<br>Renewed: November 17, 2014<br>Expires: November 17, 2017 | MA SB 2195 (6/26/14) establishes the Council on the Underground Economy; includes identification of industries where tax evasion or fraud, misclassification of employees, wage theft or the unreported payment of wages are most prevalent. | 5/11/15: Coverall North America, Inc., settled its appeal of a $4.8 million judgment entered by a federal district court on 2/05/13 in favor of a class of 166 custodians that were found to allegedly be employees under the Massachusetts' strict "ABC" independent contractor law and were misclassified as franchisees. The Court approved a $5.5 million dollar settlement which provides awards of back pay for an 11-year period and attorney's fees. The case involved several lawsuits and appeals. *Awuah, et al v Coverall North America, Inc.,* UDC MA 07-10287; 1st Cir. Nos. 13-2190, 13-2274.<br>4/21/15: The MA Supreme Judicial Court held that Boston licensed taxicab drivers are independent contractors and were not misclassified. *Sebago v. Boston Cab Dispatch, Inc.,* No. SJC-117579 (Sup. Jud. Ct. Mass. April 21, 2015). |
| **Michigan** | No Agreement | | 6/15/15: DOL investigations found that Ann Arbor restaurants owe nearly $150,000 in back wages. DOL is conducting ongoing investigations of restaurants, hotels and resorts in college towns throughout the Midwest, including Iowa, Indiana, Illinois and Michigan. The Ann Arbor investigation found violations allegedly including misclassifying employees as independent contractors.<br>3/26/15: The Sixth Circuit reversed and remanded the District Court's grant of summary judgment in favor of Miri Microsystem, LLC (a satellite-internet-dish installation company), arising from a case filed by Michael Keller alleging that Miri's payment system violates the FLSA. Keller alleged that he worked six days a week from 5:00 am to midnight, taking only Sunday off, completed two to four installations per day, and he had to travel between jobs. Miri paid Keller $110 per installation and $60 for each repair he performed. Miri did not withhold federal payroll taxes from Keller's payments or provide Keller benefits. The appeal court considered seven factors in its determination and concluded that it could reasonably find that Keller was a Miri employee. *Keller v. Miri Microsystems LLC*, No. 14-1430 (6th Cir. Mar. 26, 2015). |

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| **Minnesota** | Signed: September 19, 2011<br>Amended: October 24, 2014<br>Expires: October 24, 2017 | MN SB 1653 (5/14/12) adds company and limited liability partnership to the definition of a person; defines a business entity; clarifies the criteria for classification as an independent contractor .... | |
| **Mississippi** | No Agreement | | |
| **Missouri** | Signed: September 19, 2011<br>Renewed: November 1, 2014<br>Expires: November 1, 2017 | | 8/21/15: FedEx Ground won the right to re-try a case won on summary judgment by independent contractor drivers where the district court ruled the operators were employees per Missouri law. FedEx appealed to the Eighth Circuit, which agreed with FedEx that summary judgment was improperly granted because it was up to a jury, not a judge, to decide whether drivers are independent contractors where Missouri law provides that a worker's employment status is an issue of fact. FedEx introduced evidence that the drivers could hire others to do their jobs and could sell their territories. The federal appeals court determined that a genuine factual dispute existed as to whether the drivers were ICs or employees, and that issue should have been submitted to a jury. *Gray v. FedEx Ground Package System*, 14-cv-3232 (8th Cir. August 21, 2015). |
| **Montana** | Signed: September 26, 2011<br>Renewed: October 15, 2014<br>Expires: October 15, 2017 | MT HB 84 (3/16/11) provides that the definition of an employee does not include an independent contractor with respect to general obligations of employers; ... updates the reference to federal law with respect to the | |

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| | | definition of a person in an outside sales capacity.<br><br>MT SB 242 (4/21/11) revises the definition of employee with respect to temporary agricultural employment.<br><br>MT SB 287 (4/15/11) requires corporate officers or managers of limited liability companies working in the construction industry to be covered by workers' compensation or to obtain an independent contractor exemption certificate.<br><br>MT SB 290 (4/15/11) excludes an independent contractor from the definition of employee under human rights laws. | |
| **Nebraska** | No Agreement | | |
| **Nevada** | No Agreement | NV SB 224 (6/02/15) establishes a conclusive presumption that a person is an independent contractor | 2/02/15: Intelliconnect Communications, LLC, and S&M Management Services, Inc., were ordered to pay $560,000 in back wages and damages to 398 employees arising from a lawsuit filed by USDOL. The Court found that Intelliconnect classified its telemarketers as independent contractors and paid them on |

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| | | if certain conditions are met. The bill defines independent contractor.<br><br>NV SB 328 (6/6/11) revises the definition of professional to include creative professionals who are not employees of a contractor within the kinds of employees who are exempt from the overtime requirement. | a percentage of individual sales, resulting in many of them working for days and weeks for little or no pay. The Court ordered that Intelliconnect be independently monitored for the next three years. *USDOL v S&M Management Services, Inc.*, et al., 2:14-cv-01868. |
| **New Hampshire** | Signed: November 12, 2014<br>Expires: November 12, 2017 | NH HB 420 (6/07/12) clarifies the definition of employee and the criteria for exempting workers from employee status; redefines employee to include a person who holds himself or herself out to be in business for himself or herself or is registered with the state as a business and the person has continuing or recurring business liabilities or obligations. | |
| **New Jersey** | No Agreement | | 8/03/15: Lowe's Home Centers was sued by installers in a class action alleging Lowe's retained power over independent contractors by requiring them to follow Lowe's Installer Standards of Courtesy and Professionalism, which set forth specific instructions and rules regarding how installers are to perform their services, what to wear, the timing of the completion of installation projects, and the amounts of |

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| | | | commercial, workers' compensation, and employers' liability insurance each installer had to maintain in order to perform services for customers of Lowe's. *Mittl v. Lowe's Home Centers, LLC,* No. L2142-15 (Super. Ct. N.J. August 3, 2015).<br>4/15/15: Macy's and HomeDeliveryLink (HDL), a logistics company for Macy's, agreed to a settlement of $2.8 million for misclassification claims brought by 300 furniture delivery drivers and helpers. The drivers alleged they were required to use delivery helpers approved by HDL; were given delivery lists over which they had no input; were required to adhere to rigid schedules or risk discipline; were given appearance/shaving requirements; made to wear a uniform; and the helpers were jointly employed by Macy's and HDL. *Badia v. HomeDeliveryLink, Inc.*, 2:12-cv-06920 (NJ).<br>1/14/15: The NJ Court of Appeals considered a certified question of law submitted by the United States Court of Appeals for the Third Circuit pursuant to Rule 2:12A-1. Specifically, the Court decides which test should be applied under New Jersey law to determine whether a plaintiff is an employee or an independent contractor for purposes of resolving a wage-payment or wage-and-hour claim. The NJSC held The "ABC" test derived from the New Jersey Unemployment Compensation Act, N.J.S.A. 43:21-19(i)(6), governs whether a plaintiff is an employee or an independent contractor for purposes of resolving a wage-payment or wage-and-hour claim. *Hargrove v. Sleepy's, LLC*, No. A-70-12(072742) (NJ). |
| **New Mexico** | No Agreement | | |
| **New York** | Signed: November 18, 2013<br>Expires: November 18, 2016 | NY SB 5867 (1/10/14) amends the State Labor Law by enacting the New York State Commercial Goods Transportation Industry Fair Play Act; provides that any person performing commercial goods transportation | 10/14/15: TXX Services, a freight carrier, prevailed in a suit brought by two delivery guys who delivered prescription medicines and other freight. The magistrate judge found that the drivers were not assigned work by the company but rather bid for particular routes or areas; used their own vehicles; no uniforms or grooming standards were required; scanners leased by the company were optional; and only two mandatory meetings were held in eight years. Many requirements were customer driven. Other factors include |

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| | | services for such a contractor is an employee unless the person is a separate business entity that meets specified criteria, in which case the person shall be an independent contractor; updates the term employee in the State Workers' Compensation Law to include a person providing such services. | driver's opportunity for profit by non-exclusivity of services, the ability of driver to hire additional drivers and use additional vehicles to service multiple routes and the non-permanent nature of the relationship. The Court reached the same conclusion of IC status under the NY Labor Law. *Thomas v TXX Servs., Inc.,* 2:13-cv-02789.<br>6/29/15: The Second Circuit affirmed the district court's grant of summary judgment for the US Tennis Assoc. which determined that umpires were independent contractors because they are highly skilled; have a high degree of independent initiative and control in officiating; free to decide each year whether to apply to officiate, number of days to officiate; may serve for other associations; maintain other non-umpiring jobs; work at their convenience; did not receive fringe benefits and were not on USTA's payroll. *Meyer v. United States Tennis Association,* 14-3891-cv (2d Cir).<br>6/16/15: Model Service LLC dba MSA Models and Susan Levine was denied its motion to dismiss a claim brought by Eva Agerbrink alleging "fit" models were misclassified as independent contractors. The plaintiff has not yet asked for class certification. *Agerbrink v. Model Service LLC d/b/a MSA Models*, No. 14-CV-7841 (NYSD)<br>3/15/15: Rick's Cabaret has settled a misclassification case brought by exotic dancers in New York City for up to $15 million. *Hart v. Rick's Cabaret International, Inc.*, 09-cv-3043 (PAE) (NYSD) |
| **North Carolina** | No Agreement | NC 13 2012 Executive Order 125 establishes the Governor's task force on employee misclassification to protect the health, safety and benefits of workers, eliminate any competitive advantage currently enjoyed by businesses who violate | 1/22/15: The NC Div. of Employment Security announced in a press release that it led the southeastern region of states in discovery of misclassified workers during 2013 and is likely to remain at the top of that list. |

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| | | the law, and educate employers and employees regarding applicable legal requirements relevant to the practice of employee misclassification. | |
| **North Dakota** | No Agreement | | |
| **Ohio** | No Agreement | | 10/02/15: Greenville Architectural Glass was sued by USDOL for $46,000 for back pay, damages and civil money penalties allegedly due to repeat and willful violations and seeks to enjoin the company from violating FLSA in the future. The suit alleges Greenville misclassified window installers as independent contractors. *Perez v Greenville Architectural Glass, LLC*, 3:15-cv-00350. |
| **Oklahoma** | No Agreement | | 6:22/15: USDOL is conducting an enforcement and education initiative to address typical construction industry problems including misclassifying employees as independent contractors due to a heavy construction boom by OK DOT on aging bridges and roads. |
| **Oregon** | No Agreement | OR HB 2157 (6/9/11) requires applicant for landscape contracting business license that is nonexempt independent contractor to provide workers' compensation insurance coverage for employees; requires applicant for landscape contracting business license that is exempt independent contractor and enters into contract with worker leasing company or temporary | 2/19/15: Oak Grover Cinemas, Inc., and several other businesses owned by David Emani were ordered by the court after a four-day bench trial to pay double damages of $512,000. USDOL found that Emani employees were classified as independent contractors and kept track of their work hours on two separate time cards and were issued two separate checks for each pay period – one from Oak Grove and the other from one of the other companies *Perez v. Oak Grove Cinemas Inc., et al.*, 03:13-cv-00728-HZ.<br>10/14/15: Oregon Bureau of Labor and Industries (BOLI) issued an Advisory Opinion finding Uber (an on-demand ride-sharing firm) drivers are employees under Oregon Law. ... Oregon's economic realities test, the basis for the analysis, is comprised of the following factors: (1) The degree of control exercised by the alleged employer; (2) The extent of the relative investments of the worker and the alleged |

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| | | service provider to verify that workers supplied to business by leasing company or service provider are covered by workers' compensation insurance | | employer; (3) The degree to which the worker's opportunity for profit and loss is determined by the alleged employer; (4) The skill and initiative required in performing the job; (5) The permanency of the relationship; and, (6) The extent to which the work performed by the worker is an integral part of the alleged employer's business. |
| **Pennsylvania** | No Agreement | | 9/22/15:<br><br><br><br><br><br><br><br><br><br>3/11/15: | Uber was sued in a Pennsylvania state court seeking class certification by a driver claiming that Uber allegedly failed to pay reasonable expenses incurred by the drivers, failed to pay drivers the minimum wages and unlawfully withheld gratuities intended for the drivers but retained by Uber in violation of Pennsylvania labor law. The allegations are very similar to those in the *Ogunmokun* case filed in NY state court, and there have been other cases and court rulings against Uber in California. *DiNofa v. Uber Technologies, Inc.,* No. 150902252 (Pa. Ct. of Common Pleas, Sept. 22, 2015.<br>A Pennsylvania Federal District Court granted class certification to the case filed against Jani-King, Inc. (a large international commercial cleaning franchisor) arising from allegations that Jani-King misclassified franchisees as independent contractors, that Jani-King sold rights to its cleaning services franchise but, in reality, the franchise agreements are employment contracts, and that Jani-King took improper deductions from their wages. *Myers v. Jani-King of Philadelphia, Inc.,* No. 09-1738 (PAED). |
| **Rhode Island** | Signed: May 7, 2015<br>Expires: May 7, 2018 | RI HB 7564 (6/25/12) requires the disclosure by state agencies of certain labor-related information necessary to investigate certain violations including misclassification of employee status and wage and hour violations; amends the | 9/01/15:<br><br><br><br><br><br><br><br>10/13/15: | Cardoso Construction LLC agreed to pay more than $730,000 in back wages, interest and penalties. A new Workplace Fraud Unit within the Dept. of Labor and Training's Workplace Regulation and Safety division reached a settlement with Cardoso after an investigation found the company had mischaracterized employees as independent contractors. This is the first significant action of the new unit.<br>Mancieri Flooring Co. LLC was assessed $331,000 in back wages and treble damages and penalties by the RI DLT for allegedly (1) misclassifying 17 workers as independent |

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| | | powers and duties of the tax administrator to include providing any state tax information, state records, or state documents to assist in investigations; provides for the confidentiality of materials to be maintained to the extent required. (See also RI SB 3039)<br><br>RI SB 416 (7/13/11) requires every contractor and subcontractor to maintain on the site where public works are being constructed and the general or primary contract is three million dollars ($3,000,000) or more, a daily log of employees employed each day on the public works project; provides that the log shall include for each employee his or her name, primary job title, and employer and shall be kept on a uniform form. | | contractors, (2) failing to pay proper wage rates and overtime, (3) failing to pay the prevailing wage rate on flooring removal/installation work the company was subcontracted to perform at the University of Rhode Island, (4) continuing a pattern of deceit in falsifying payroll records, and (5) supplying false 1099 forms to the state. |
| South Carolina | No Agreement | | 3/18/15: | The South Carolina Supreme Court ruled that LeAndra Lewis, an exotic dancer, was an employee of Studio 54 Boom Room, and thus eligible for worker's compensation. Lewis was injured by an errant bullet while working at the club. |

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| | | | *Lewis v. L.B. Dynasty d/b/a/ Boom Room Studio 54*, No. 2012-213376 (S. Ct. S.C.). |
| **South Dakota** | No Agreement | | |
| **Tennessee** | No Agreement | TN HB 1441 (4/24/14) provides an exemption for motor carriers that utilize independent contractors who perform services as drivers.<br><br>TN SB 2251 (4/1/14) revises provisions regarding the contractual relationship between a common carrier and a leased operator or leased owner/operator<br><br>TN SB 833 (5/22/13) creates a civil penalty for a construction services provider who misclassifies employees to avoid proper classification for worker compensation premium calculations by concealing information pertinent to the computation and application of an experience rating modification factor or by materially understating or concealing the | |

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| | | amount of the construction services provider's payroll, the number of employees, and any of the construction services. | |
| **Texas** | Signed: February 15, 2015<br>Expires: February 15, 2018 | TX HB 2015 (6/27/13) requires a person who contracts with a governmental entity to provide a service to properly classify as an employee or independent contractor; provides for a person directly retained and compensated who contracts with a government entity; requires a person who fails to properly classify an individual to pay to the commission a penalty for each individual that the person has not properly classified. | 7/02/15: The Fifth Circuit sanctioned the USDOL by imposing attorneys' fees on USDOL under the "acted in bad faith ..." provision of EAJA and rendered a scathing opinion of the government's conduct. The case arises from a lawsuit filed by Gate Guard (a limited partnership that provides services to oil field operators by contracting with gate attendants) against the USDOL. The district court granted Gate Guard $565,000 in attorneys' fees under the "not substantially justified" provision of the EAJA. The Fifth Circuit reversed and remanded, stating: "[The government] can start to repair the damage done by erroneously, indeed vindictively, attempting to sanction an innocent business. Rather than acknowledge its mistakes, however, the government chose to defend the indefensible in an indefensible manner." *Gate Guard Services L. P. v. Solis*, No. 14-40585 (5th Cir.).<br>3/12/15: A federal jury awarded over $125,000 in damages to two exotic dancers against Tiffany's Cabaret in San Antonio for multiple FLSA violations including misclassification as independent contractors, no overtime pay, and requiring that they split their tips with other workers, the DJ and the club. *Alex v. KHG of San Antonio LLC*, 5:13-cv-00728 (TXWD)<br>3/3/15: More than $180,000 in back wages have been awarded to 639 employees in the Dallas and Abilene areas following a USDOL investigation which found the practice of working off the clock allegedly a widespread problem in the hotel industry where staffing agencies provide workers. The investigation alleged some employees were illegally misclassified as independent contractors.<br>2/26/15: The US Tax Court ruled that TFT Galveston (an apartment complex) maintenance supervisors, maintenance workers and apartment managers were employees and held it liable |

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| | | | | for employment taxes. The Court concluded "None of the relevant factors suggest that the workers were independent contractors, and many of the factors evidence an employer-employee relationship. ... the workers were all ultimately subject to the direction and control of Mr. Teachworth. He hired them and set their hours and wages. They had no financial investment in the work they performed. They bore no risk of financial loss, and they did not participate in TFT Galveston Portfolio's profits in any way." *TFT Galveston Portfolio, Ltd. v. Commissioner of Internal Revenue,* 144 T.C. No.7 |
| | | | 1/29/15: | Specialty Painting & Wall Covering, Inc., and M & S Enterprise (jointly owned) have paid 22 painters and sheetrock installers more than $180,000 in back wages arising from a USDOL investigation wherein workers were found to have been misclassified as independent contractors. The investigation found that workers at Specialty were paid up to 40 hours by Specialty, but after working over 40 hours they were paid with a separate check from M&S at their straight-time rate (no taxes withheld), and that M&S workers were misclassified as independent contractors. |
| **Utah** | Signed: September 19, 2011<br>Renewed: October 6, 2014<br>Expires: October 6, 2017 | UT SB 22 (5/14/13) modifies repeal date of Worker Classification Coordinated Enforcement Council.<br><br>UT SB 11 (3/31/11) Worker Classification Coordinated Enforcement changes name and addresses membership, the duties of the council, and the sharing of information. | 4/23/15: | CSG Workforce Partners, Universal Contracting LLC, and Arizona Tract/Arizona CLA have entered a consent order yielding $700,000 for over 1,000 wrongly classified construction workers arising from a five-year USDOL investigation. Construction workers were required to become members/owners of LLCs, stripping them of federal and state protections. The construction workers were building houses in UT and AZ. *Perez v. Universal Contracting LLC et al.*, 2:13-cv-253-DS; *Perez v Arizona CLA LLC*, et al., 2:15-cv-00461-JAT |
| | | | 6/01/15 | More than 2,700 Utah construction workers were found to be underpaid nearly $2 million as a result of USDOL investigations. The USDOL claimed that many of the workers were misclassified as independent contractors. |
| **Vermont** | Signed: August 13, 2015 | VT HB 646 (6/5/14) | | |

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| | Expires: August 13, 2018 | unemployment insurance to include the investigation of complaints of unpaid wages, penalties for quarterly wage reporting and misclassification of employees.<br><br>VT SB 220 (6/24/14) amends the workers' compensation law, establishes a registry of sole contractors ...<br><br>VT Executive Order 2012-08 (issued 9/12/12) provides for the Governor's Task Force on Employee Misclassifi-cation. | |
| **Virginia** | No Agreement | VA HB 1859 (3/25/11) requires public contractors and their subcontractors to register and participate in a federal Electronic Work Verification Program to determine that their employees and individual independent contractors are legally eligible for employment in the United States; ... verify the employment status of their employees and | 7/01/15: Virginia DOL announced it is implementing a new OSHA policy effective 7/01/15 for preventing the misclassification of workers as independent contractors. |

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| | | independent contractors; provides that a state public body shall deny prequalification to any contractor who fails to participate.<br><br>VA SJR 345 (adopted 2/23/11) DOL, Board for Contractors within the Dep. of Professional and Occupational Regulation, to study the misclassification of employees as independent contractors in the Commonwealth; ... the Department shall review the status of employee misclassify-cation in the state, review the consequences of misclassification to the workforce, determine the amount of lost revenue to the state and local. | |
| **Washington** | Signed: September 19, 2011<br>Renewed: October 27, 2014<br>Expires: October 27, 2017 | WA SB 5476 (5/03/13) provides that the exclusions from unemployment insurance, industrial insurance, and the minimum wage for certain newspaper | 2/05/15: The DOL Seattle District Office is undertaking a multi-year enforcement and outreach initiative to educate the janitorial industry and identify employers that violate laws governing minimum wage and overtime pay or fail to pay workers for all hours worked. Seattle District Office investigators will visit Washington retail stores and other businesses to ensure janitorial workers are paid in compliance with federal laws and will check for compliance |

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| | | services are modified and made consistent; provides that newspaper vendors, carriers, or delivery persons selling or distributing newspapers on the street, to offices, to businesses, or from house to house are excluded; excludes any freelance news correspondence or stringer who, using their own equipment, submits material for free or a fee when the material is published. | with the record-keeping, hours worked, child labor and anti-retaliation provisions of the FLSA. |
| **West Virginia** | No Agreement | | |
| **Wisconsin** | Signed: December 23, 2014<br>Expires: December 23, 2017 | | 4/03/15: Wisconsin Dept. of Workforce Development was denied summary judgment in a case brought by a government vendor classified as an independent contractor who provided job development and job coaching services. The vendor submitted evidence including an "agreement for services" setting out requirements and review of performance outcomes; the Dept. supplied her with a computer, printer and software; provided her with training and annual reviews; and a document in which the Dept. concluded the vendor was an employee under WI law for unemployment purposes because of the amount of control the Dept. had over the vendor. In the court's view, this evidence submitted by the vendor created genuine issues of material fact that need to be decided at trial with respect to whether she was an independent contractor or employee. *Williams v. Wisconsin Department of Workforce Development,* No. 13-CV-794-BBC (W.D. Wisc. April 3, 2015). |
| **Wyoming** | Signed: October 27, 2014 | WY SB 153 (3/13/13) | |

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| | Expires: October 27, 2017 | amends the exclusion from coverage for newspaper carriers to include direct sellers or independent contractors; provides exclusion criteria. | |
| **Puerto Rico** | No Agreement | | 8/18/15: PR Coffee Roasters, a subsidiary of Coca-Cola Puerto Rico Bottlers, agreed to pay nearly $68,000 in back wages and damages arising from a USDOL investigation of failure to pay minimum wage and the misclassification of bag fillers as independent contractors and delivery drivers as outside salesmen.<br>5/11/15: Alpha Guards Management, Inc., a security firm, was required to pay nearly $350,000 in back wages and damages arising from a USDOL investigation and a USDC consent order for failure to pay overtime wages and misclassifying employees as independent contractors. *USDOL v. Alpha Guards Management Inc., et al.*, 3:15-cv-01381. |

## IV. BEST PRACTICES

- Independent contractor is paid for a job, not by the hour, because the focus is completion of a job, not completion of work by the hour. Thus, an independent contractor is typically paid a flat fee for a job or project

- Independent contractor should not be required to work at specific times -- work hours are set by the independent contractor

- There are no requirements on the order or sequence of the work

- Unless the work cannot be performed somewhere else, the independent contractor has the right to choose where the work will be performed

- Independent contractors should not be working under specific instructions or direction of the business about how to accomplish the job -- the more detailed the instructions given, the more likely a finding that the worker is an employee

- Independent contractor should not require training by the business to complete the task -- training may evidence that the entity wants the work performed in a particular way and is exercising control over the worker

- Independent contractor can typically not be restricted from advertising or working for others in the relevant job market

- Independent contractors typically uses his/her own tools or equipment

- Services do not have to be rendered personally: An independent contractor can go out and hire another to assist in performance of the job

- The independent contractor relationship is not a continuing relationship – there should be a defined time period or project to complete

- Independent contractors bear the risk of realizing a profit or incurring a loss

## V. RESOURCES AND PUBLICATIONS

***United States v. Silk*, 331 U.S. 714 (1947) -- Where it all began**
Identified 5 factors for determining independent contractor classification:

1. The degree of control exercised by the alleged employer
2. The degree to which the "employee's" opportunity for profit or loss is determined by the employer

3. The extent of the relative investments of the putative employee and employer
4. The permanency of the relationship, and
5. The skill and initiative required in performing the job.

- **Administrator David Weil's Interpretation No. 2015-1, released July 15, 2015, by the USDOL, Wage and Hour Div.,** regarding the Application of the Fair Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who Are Misclassified as Independent Contractors.

- **U.S. Labor Department Awards More Than $39 Million to 45 States to Reduce Worker Misclassification.** On September 22, 2015, the USDOL announced that more than $39.3 million in federal grants were awarded that will enhance unemployment insurance programs in 45 states, including District of Columbia, and Puerto Rico, and reduce the misclassification of employees as independent contractors. The funding will help prevent and detect improper benefit payments, improve program performance, address outdated information technology systems, and combat employee misclassification that underpays and denies benefits to workers and hurts local economies.

- **A US Tax Court finds** maintenance supervisor, maintenance workers, and apartment managers of apartment complex owned by TFT Galveston Portfolio, Ltd. to be employees and not independent contractors resulting in employment tax liabilities for the owner. Applying the definition set forth in the Employment Tax Regulations and the seven factors enumerated in *Weber v. Commissioner,* 103 T.C. 378 (1994), aff'd per curiam, 60 F.3d 1104(4th Cir. 1995), the Court found that the workers in question had been misclassified as 1099ers instead of W-2 employees and that the taxpayer business was liable for unpaid employment taxes, interest and penalties for failure to file Form W-2s for the workers in question. In reaching its misclassification holding, the Tax Court found, among other facts, that TFT controlled nearly every aspect of the work performed by the apartment managers and maintenance supervisor; that the maintenance workers were subject to supervision by TFT; that managers were provided with on-site housing paid by THT; that all incidental expenses were paid by TFT; that either party could end the relationship at any time; and that there were no independent contractor agreements or any written contracts defining the workers' relationship with THT. *TFT Galveston Portfolio, Ltd. v. Commissioner of Internal Revenue*, 144 T.C. No.7 (Feb. 26, 2015).

- **EEOC Guidance (1997)**: The EEOC created a comprehensive, non-exclusive list of factors to evaluate whether a staffing firm or its client (or both) exercise sufficient control over manner and means of work to constitute an "employer." These factors include whether:
  - firm or client has right to control when, where, and how worker performs the job;
  - work does not require a high level of skill or expertise;

- firm or client rather than worker furnishes tools, materials, and equipment;
- work is performed on premises of firm or client;
- there is a continuing relationship between worker and firm or client;
- firm or client has right to assign additional projects to worker;
- firm or client sets hours of work and duration of job;
- worker is paid by hour/week/month rather than agreed cost of performing particular job;
- worker has no role in hiring and paying assistants;
- work performed by worker is part of regular business of firm or client;
- firm or client is itself in business;
- worker is not engaged in his or her own distinct occupation or business;
- firm or client provides worker with benefits (e.g., insurance, LOA, workers' comp);
- worker is considered an employee of the client for tax purposes (i.e., which entity withholds federal, state & Social Security taxes);
- firm or client can discharge worker; and
- worker and firm or client believe they are creating employer-employee relationship.

**SOURCES:**

- Misclassification and independent contractor information: www.dol.gov/whd/workers/misclassification

- Tax form for determination of worker status for withholding purposes: https://www.irs.gov/uac/About-Form-SS8

- GAO whitepaper regarding Contingent Workforce: Size, Characteristics, Earnings, and Benefits. http://www.gao.gov/products/GAO-15-168R

- USDOL News Briefings: www.dol.gov/whd/workers/misclassification

- Blogs: http://wagehourlaw.foxrothschild.com; http://independentcontractor compliance.com/

- Employee misclassification-National Conference of State Legislators: http://www.ncsl.org/research/labor-and-employment/employee-misclassification-resources.aspx.

**JOINT EMPLOYER STATUS UNDER THE NATIONAL LABOR RELATIONS ACT: THE WINDS ARE SHIFTING**

**AN NLRB CASE LAW UPDATE**

**By: John A. Ferguson, Schmoyer Reinhard, LLP**

## I. INTRODUCTION

On August 27, 2015, in a 3-2 landmark decision involving Browning-Ferris Industries of California ("BFI"), the National Labor Relations Board (the "Board") refined its standard for determining joint-employer status. According to the NLRB's Office of Public Affairs:

> The revised standard is designed "to better effectuate the purposes of the Act in the current economic landscape." With more than 2.87 million of the nation's workers employed through temporary agencies in August 2014, the Board held that its previous joint employer standard has failed to keep pace with changes in the workplace and economic circumstances.
>
> In the decision, the Board applied long-established principles to find that two or more entities are joint employers of a single workforce if:
>
> > (1) they are both employers within the meaning of the common law; and
> >
> > (2) they share or codetermine those matters governing the essential terms and conditions of employment.
>
> In evaluating whether an employer possesses sufficient control over employees to qualify as a joint employer, the Board will -- among other factors -- consider whether an employer has exercised control over terms and conditions of employment indirectly through an intermediary, or whether it has reserved the authority to do so.
>
> In its decision, the Board found that BFI was a joint employer with Leadpoint, the company that supplied employees to BFI to perform various work functions for BFI, including cleaning and sorting of recycled products. In finding that BFI was a joint employer with Leadpoint, the Board relied on indirect and direct control that BFI possessed over essential terms and conditions of employment of the employees supplied by Leadpoint as well as BFI's reserved authority to control such terms and conditions.[1]

[1] National Labor Relations Board ("NLRB") *Board Issues Decision in Browning-Ferris Industries* (NLRB Office of Public Affairs, August 27, 2015) https://www.nlrb.gov/news-outreach/news-story/board-issues-decision-browning-ferris-industries (last visited Nov. 23, 2015).

The purpose of this paper is to briefly review the history of the NLRB's joint employer standard, to describe the Board's new standard, and to address how the Board is applying that standard to date, and is likely to be interpreted by the Board in future cases. This paper will also discuss how the NLRB is dealing with the issue of whether franchisors may be considered joint employers with their franchisees, including an update and overview of the Board's pending litigation against McDonald's USA LLC involving that issue. Finally, this paper will also provide a brief update on the status of the NLRB's existing precedent that allows contingent employees supplied by a temporary staffing agency and who are referred to work for a user employer the option of organizing along with the user employer's employees only if the supplier employer and user employer both consent.

This paper is not intended to address every legal issue that may arise under the NLRB's joint employer definition(s), but is instead intended to provide an overview of the current law, including actual and potential changes in the law.

## II. BRIEF HISTORY AND OVERVIEW OF THE NLRA AND THE NLRB'S JOINT EMPLOYER STANDARD

### A. The Wagner Act, Section 7 Rights, Definition of Employees and Their Employer, and Duty to Bargain

The Wagner Act (now known as the National Labor Relations Act) was enacted on July 8, 1935. The NLRA gave employees of most private sector employees the right, for the first time, to join, organize and assist labor unions. It also gave those same employees the right to engage in "protected concerted activities," even if those activities do not involve union activities.

The NLRA covers most, but not all, private sector employers. NLRA Section 2(2) excludes from the definition of "employer" the United States government, wholly owned government owned corporations, the Federal Reserve Bank, state and political subdivisions and persons subject to the Railway Labor Act (railroads and airlines). The NLRA also does not apply to entities over which the NLRB has been found not to have jurisdiction, such as certain religiously-affiliated private schools.

Section 7 is the heart of the NLRA. It provides, in relevant part, as follows:

> "Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all such activities…"

Section 8 of the NLRA (the "Act") protects employees' Section 7 entitlements, making it an unfair labor practice for an employer to interfere with, restrain, or coerce employees in the exercise of their Section 7 rights.

In order to find that a statutory employer (i.e., an employer subject to the National Labor Relations Act) has a duty to bargain with a union representing a particular group of statutory employees, the Act requires the existence of an employment relationship between the employer and the employees.

Section 2(3) of the Act provides that the "term 'employee' . . . shall not be limited to the employees of a particular employer, *unless the Act explicitly states otherwise*." (emphasis added).

Section 9(c) of the Act authorizes the Board to process a representation petition when it alleges that "employees . . . wish to be represented for collective bargaining . . . and *their* employer declines to recognize their representative."

Finally, Section 8(a)(5), in turn, makes it an unfair labor practice for an employer "to refuse to bargain collectively with the representatives of *his* employees." (emphasis added).

**B. Definition of Joint Employer**

The NLRB has long relied on the joint employer doctrine to expand employer liability for unfair labor practices and impose obligations for collective bargaining or compliance with a collective bargaining agreement with respect to a completely separate entity.

Joint employer status is distinguished from that of a single employer or integrated enterprise in that in the joint employer situation, the businesses in issue are concededly separate and distinct and do not share ownership, management or financial control. Rather, the issue in the joint employer context is the extent to which the separate companies exercise control over the same employees. *NLRB v. Browning-Ferris Indus. of Pa., Inc.*, 691 F.2d 1117, 1122-23 (3d Cir. 1982).

**C. Evolution of the NLRB's Joint Employer Standard**

During the period prior to the issuance of the Third Circuit's decision in *Browning Ferris Industries of Pennsylvania, Inc.*, 691 F.2d 1117 (3d Cir. 1982), enfg. 259 NLRB 148 (1981)(which endorsed the Board's then long standing standard), the Board typically treated the *right* to control the work of employees and their terms of employment as probative of joint-employer status. The Board did not require that this right be exercised, or that it be exercised in any particular manner. Thus, the Board's joint-employer decisions found it probative that employers retained the contractual power to reject or terminate workers; set wage rates; set working hours; approve overtime; dictate the number of workers to be supplied; determine "the manner and method of work performance;" "inspect and approve work;" and terminate the contractual agreement itself at will. The Board stressed that "the power to control is present by virtue of the operating agreement." Reviewing courts expressly endorsed this approach. See *Browning Ferris Industries of California, Inc.*, 362 NLRB No. 186 at p. 9 (2015) ("*BFI of CA*").

In addition to recognizing the right to control as probative, the Board gave weight to a putative joint employer's "indirect" exercise of control over workers' terms and conditions of employment. In so doing, the Board emphasized that, in order to exercise significant control, a putative employer need not "hover over [workers], directing each turn of their screwdrivers and each connection that they made." Instead, the Board assessed whether a putative employer exercised "ultimate control" over their employment. *BFI of CA*, at p. 9.

Consistent with this principle, the Board in certain cases found evidence of joint-employer status where a putative employer, although not responsible for directly supervising another firm's employees, inspected their work, issued work directives through the other firm's supervisors, and exercised its authority to open and close the plant based on production needs. Likewise, the Board found significant indicia of control where a putative employer, although it "did not exercise direct supervisory authority over" the workers at issue, nonetheless held "day-to-day responsibility for the overall operations" of the worksite and determined the scope and nature of the contractors' work assignments. Contractual arrangements under which the user employer reimbursed the supplier for workers' wages or imposed limits on wages were also viewed as tending to show joint employer status. *BFI of CA*, at p. 9.

### D. The Third Circuit's 1982 Decision in *Browning Ferris of Pennsylvania* and Subsequent NLRB Case Law

In 1982, the Third Circuit issued its decision in *Browning Ferris Industries of Pennsylvania, Inc.*, 691 F.2d 1117 (3d Cir. 1982), enfg. 259 NLRB 148 (1981) ("*BFI of Pa*."). According to the NLRB's August 27, 2015 decision in *BFI of CA,,* the Third Circuit's decision in *BFI of Pa*. "did not question, much less reject, any of the [above] lines of Board precedent. That decision, rather, carefully untangled the joint-employer doctrine from the distinct single employer doctrine (which addresses integrated enterprises only nominally separate), endorsed the Board's "share or codetermine" formulation, and enforced the Board's order finding joint-employer status. The Third Circuit explained:

> The basis of the [joint employer] finding is simply that one employer while contracting in good faith with an otherwise independent company, has retained for itself sufficient control of the terms and conditions of employment of the employees who are employed by the other employer. . . .Thus, the "joint employer" concept recognizes that the business entities involved are in fact separate but that they *share or codetermine those matters governing the essential terms and conditions of employment.* 691 F.2d at 1123 (citations omitted; emphasis added).

The Board subsequently embraced the Third Circuit's decision, but, according to the *BFI of CA* Board, those decisions simultaneously took Board law in a new and different direction. *TLI, Inc.*, 271 NLRB 798 (1984), enfd.mem. 772 F.2d 894 (3d Cir.

1985), and *Laerco Transportation*, 269 NLRB 324 (1984), both decided in 1984, "marked the beginning of a 30-year period during which the Board—without any explanation or even acknowledgement and without overruling a single prior decision—imposed additional requirements that effectively narrowed the joint-employer standard. *Most significantly, the Board's decisions [beginning in 1984] … implicitly repudiated its earlier reliance on reserved control and indirect control as indicia of joint-employer status*." (emphasis added). *BFI,* at p. 10.

## III. THE NLRB's AUGUST 27, 2015 DECISION IN *BROWNING FERRIS OF CALIFORNIA*

The *Browning-Ferris Industries of California* case arose in the context of a petition for a representation election in which the union, Sanitary Truck Drivers and Helpers Local 350, International Brotherhood of Teamsters (the "Union"), sought to have Browning-Ferris ("BFI") and staffing agency Leadpoint Business Services Inc. treated as joint employers for collective bargaining purposes. NLRB Case No. 32-RC-109684 (petition filed July 22, 2013). There were some 300 employees who worked at the BFI facility—60 were employed by BFI and the rest were employees of the staffing agency. On August 16, 2013, an NLRB Regional Director ruled that BFI and Leadpoint were not joint employers and directed an election among Leadpoint employees who worked as sorters at a BFI-owned recycling facility.

On August 30, 2013, the Union filed a Request for Review of the Regional Director's Decision with the NLRB. On April 25, 2014, an election was conducted by the NLRB Regional Director among the employees in the unit found appropriate by the Regional Director, but the ballots were impounded pending the Board's ruling on the Union's Request for Review.

The Board then invited the parties and interested amici to file briefs addressing the following questions:

1. Under the Board's current joint-employer standard, as articulated in *TLI, Inc.*, 271 NLRB 798 (1984), enfd. mem. 772 F.2d 894 (3d Cir. 1985), and *Laerco Transportation*, 269 NLRB 324 (1984), is Leadpoint Business Services the sole employer of the petitioned-for employees?

2. Should the Board adhere to its existing joint employer standard or adopt a new standard? What considerations should influence the Board's decision in this regard?

3. If the Board adopts a new standard for determining joint-employer status, what should that standard be? If it involves the application of a multifactor test, what factors should be examined? What should be the basis or rationale for such a standard?

On August 27, 2015, the Board issued its landmark decision in *BFI of California, Inc.* The Board summarized its **restated standard** for determining joint employer status, as follows:

> Today, we restate the Board's joint-employer standard to reaffirm the standard articulated by the Third Circuit in *Browning-Ferris [of Pa.]* decision. Under this standard, the Board may find that two or more statutory employers are joint employers of the same statutory employees if they "share or codetermine those matters governing the essential terms and conditions of employment." In determining whether a putative joint employer meets this standard, the initial inquiry is whether there is a common-law employment relationship with the employees in question. If this common-law employment relationship exists, the inquiry then turns to whether the putative joint employer possesses sufficient control over employees' essential terms and conditions of employment to permit meaningful collective bargaining.
>
> Central to both of these inquiries is the existence, extent, and object of the putative joint employer's control. Consistent with earlier Board decisions, as well as the common law, we will examine how control is manifested in a particular employment relationship. We reject those limiting requirements that the Board has imposed— without foundation in the statute or common law— after *Browning-Ferris [of Pa.]*. We will no longer require that a joint employer not only *possess* the authority to control employees' terms and conditions of employment, but also *exercise* that authority. *Reserved authority to control terms and conditions of employment, even if not exercised, is clearly relevant to the joint-employment inquiry.* (emphasis added). *BFI of CA*, at p. 2.

Later in its decision, the Board elaborated further on its above restated standard, as follows:

> …. **we have decided to restate the Board's legal standard for joint-employer determinations and make clear how that standard is to be applied going forward:**.
>
> - We return to the traditional test used by the Board (and endorsed by the Third Circuit in *Browning-Ferris [of Pa.]*): The Board may find that two or more entities are joint employers of a single work force if they are both employers within the meaning of the common law, and if they share or codetermine those matters governing the essential terms and conditions of employment. In evaluating the allocation and exercise of control in the workplace, we will consider the various ways in which joint employers may "share" control over terms and conditions of employment or "codetermine" them, as the Board and the courts have done in the past.
>
> - We adhere to the Board's inclusive approach in defining "essential terms and conditions of employment." The Board's current joint-employer standard refers to "matters relating to the employment relationship *such as*

hiring, firing, discipline, supervision, and direction" a nonexhaustive list of bargaining subjects. Essential terms indisputably include wages and hours, as reflected in the Act itself. Other examples of control over mandatory terms and conditions of employment found probative by the Board include dictating the number of workers to be supplied; controlling scheduling, seniority, and overtime; and assigning work and determining the manner and method of work performance. This approach has generally been endorsed by the Federal courts of appeals.

- Also consistent with the Board's traditional approach, we reaffirm that the common-law concept of control informs the Board's joint-employer standard. But we will no longer require that a joint employer not only possess the authority to control employees' terms and conditions of employment, but must also exercise that authority, and do so directly, immediately, and not in a "limited and routine" manner. Accordingly, we overrule *Laerco*, *TLI*, *A&M Property*, and *Airborne Express*, supra, and other Board decisions, to the extent that they are inconsistent with our decision today. The right to control, in the common-law sense, is probative of joint-employer status, as is the actual exercise of control, whether direct or indirect.

With the above principles in mind, the NLRB stated that it would evaluate whether BFI constituted a joint employer under the NLRA, and concluded that the Union had met its burden of establishing that BFI was a joint employer in this case. The Board stated that it was relying on the following factors in reaching this conclusion:

*A. Hiring, Firing and Discipline*

BFI possesses significant control over who Leadpoint can hire to work at its facility. By virtue of the parties' Agreement, which is terminable at will, BFI retains the right to require that Leadpoint "meet or exceed [BFI's] own standard selection procedures and tests," requires that all applicants undergo and pass drug tests, and proscribes the hiring of workers deemed by BFI to be ineligible for rehire. Although BFI does not participate in Leadpoint's day-to-day hiring process, it codetermines the outcome of that process by imposing specific conditions on Leadpoint's ability to make hiring decisions. Moreover, even after Leadpoint has determined that an applicant has the requisite qualifications, BFI retains the right to reject any worker that Leadpoint refers to its facility "for any or no reason." Similarly, BFI possesses the same unqualified right to "discontinue the use of any personnel" that Leadpoint has assigned.

*B. Supervision, Direction of Work, and Hours*

BFI exercises control over the processes that shape the day-to-day work of the petitioned-for employees. Of particular importance is BFI's unilateral control over the speed of the streams and specific productivity standards for sorting….BFI managers …assign the specific tasks that need to be completed, specify where

> Leadpoint workers are to be positioned, and exercise near-constant oversight of employees' work performance. The fact that many of their directives are communicated through Leadpoint supervisors hardly disguises the fact that BFI alone is making these decisions.
>
> *C. Wages*
>
> We find … that BFI plays a significant role in determining employees' wages. Under the parties' contract, Leadpoint determines employees' pay rates, administers all payments, retains payroll records, and is solely responsible for providing and administering benefits. But BFI specifically prevents Leadpoint from paying employees more than BFI employees performing comparable work. BFI's employment of its own sorter at $5 more an hour creates a de facto wage ceiling for Leadpoint workers. In addition, BFI and Leadpoint are parties to a cost-plus contract, under which BFI is required to reimburse Leadpoint for labor costs plus a specified percentage markup. Although this arrangement, on its own, is not necessarily sufficient to create a joint-employer relationship, it is coupled here with the apparent requirement of BFI approval over employee pay increases.

Following the issuance of the NLRB's decision in *Browning Ferris of CA,* the NLRB's Regional Director for Region 32 opened and counted the ballots from the election, and the Union received a majority of the votes cast. On September 14, 2015, the Regional Director then certified the Union as the exclusive collective bargaining representative of the employees in the unit of employees who the Board found were jointly employed by BFI and Leadpoint.

On September 9, 2015, the Union requested BFI to recognize and bargain with it, and on September 21, 2015, BFI declined the Union's request. On September 25, 2015, the Union filed an unfair labor practice charge against BFI in Case 32-CA-160759 as a means of testing the Board's decision in *BFI of CA*. That charge is currently pending before the Board. Once the Board issues its decision in the unfair labor practice case, BFI will then be able to appeal that ruling to a U.S. Court of Appeals. BFI was unable to directly challenge the NLRB's decision in *BFI of CA* in court, because under the NLRA, judicial review is not available for representation case rulings.

## IV. APPLICATION OF NLRB's DECISION IN *BROWNING-FERRIS INDUSTRIES OF CALIFORNIA*

### A. Franchisor/Franchisee Issue and the "Outer Limits" of *BFI of CA*

In an interview with Law 360 conducted in early November 2015, NLRB Chairman, Mark Gaston Pearce, and Member, Philip A. Miscimarra, agreed that the Board's decision in *BFI of CA* did <u>not</u> address the franchise issue and was narrower than some critics have claimed. They both said that the application of the joint-employer liability on the franchise system is an issue that the Board will have to weigh in on again to offer the clarity employers are looking for. "Exclusive: NLRB Members Expect More on Franchise Issue" *Law 360* (November 12, 2015).

According to the Law 360 article, both Pearce and Miscimarra said that it's too soon to write an epitaph for the ubiquitous franchise system. Miscimarra said that it is difficult to ascertain exactly how the new joint-employer standard will play out at this point, but both he and Chairman Pearce said that the franchisor-franchisee relationship under the standard would end up on the docket. "That's an issue I expect will eventually be considered by the Board," Miscimarra said.[2]

Miscimarra also said that while ambiguity over employer status might affect business relationships such as those between franchiser and franchisee or vendor and client, he doesn't think there's anyone who could predict with great certainty "what the outer limits of BFI are."

For Chairman Pearce, the new standard is really about keeping up with changing economic realities. "We look at *BFI* as an opportunity for us to embrace the realities of the workplace, given all that has happened during the course of industrial evolution," he said, noting that there are nearly 3 million people who are now part of the contingent workforce. That includes bringing into negotiations parties that have the ability to effect change in terms and conditions of employment. In *Browning-Ferris*, that role belonged to the plant owner and not staffing agency Leadpoint Inc., Pearce said. "If a party that has the real power in terms of meaningful collective bargaining is not at the table, then it needed to be," Pearce said.

For Miscimarra, where the ruling does damage is in making it very difficult for employees, unions and even an employer to know who the real employer is. "There's really nothing more fundamental in our statute than identifying the employer," he said. "That's something that runs through many different aspects of our labor laws." *Law 360* (November 12, 2015).

## B. NLRB Regional Director's October 21, 2015 Decision in *Green JobWorks*

As of December 23, 2015, there had not been any NLRB decisions issued since the August 27, 2015 *Browning-Ferris of California* decision that have addressed the joint employer issue.

However, on October 21, 2015, the NLRB's Regional Director for Region 5 issued a Decision and Direction of Election ("DDE") in which he applied the NLRB's new joint employer standard as stated in *BFI of CA*, and concluded that there was insufficient evidence to establish joint employer status in that case. *Green JobWorks, LLC/ACECO, LLC*, Case 05-RC-154596 (Decision and Direction of Election, October 21, 2015) (A copy is attached under Tab 1).

[2] That may well be in connection with the McDonald's complaint cases that are currently pending before the NLRB's Regions, as discussed further below.

According to the DDE, Green JobWorks ("GJW") is a staffing company that provides temporary laborers to client construction companies, including ACECO, to perform demolition and asbestos abatement work. GJW recruits new employees, and requires applicants to pass a drug screen and a general knowledge test for demolition. Those applicants that pass are then placed into GJW's database for potential future referrals.

When GJW receives a request for laborers from ACECO, it refers to its database to determine which available employees match the requested skill set. GJW sends the selected employees to the ACECO site until it receives notice that a particular assignment is finished, or that a skill set is no longer needed.

On May 8, 2015, GJW and ACECO entered into a Master Labor Services Agreement with a Subcontract Addendum ("the MLSA"). The MLSA provided that GJW was exclusively responsible for:

a) Recruiting, hiring, assigning, orienting, reassigning, counseling, disciplining, and discharging the Employees.
b) Making legally-required employment law disclosures (wage hour posters, etc.) to them.
c) Establishing, calculating, and paying their wages and overtime.
d) Exercising human resources supervision of them.
e) Withholding, remitting, and reporting on their payroll taxes and charges for programs that GJW is legislatively required to provide (including workers' compensation).
f) Maintaining personnel and payroll records for them.
g) Obtaining and administering I-9 documentation of employees' right to work in the United States.
h) Paying employees' wages and providing the benefits that GJW offers to them.
i) Paying or withholding all required payroll taxes, contributions, and insurance premiums for programs that GJW is legislatively mandated to provide to employees as GJW's employees.
j) Providing workers' compensation benefits or coverage for employees in amounts at least equal to what is required by law.
k) Fulfilling the employer's obligations for unemployment compensation.
l) Complying with employment laws, as they apply to GJW.

On June 22, 2015, the Construction and Master Laborers' Local Union 11 (the "Union") filed a petition seeking to represent a unit of employees jointly employed by GJW and ACECO.

In his DDE, the Regional Director applied the Board's joint employer standard as stated in *BFI of CA* to the facts of this case, and concluded that the Union "failed to establish by specific, detailed evidence that ACECO had the authority to control matters governing the essential terms and conditions of GJW employees in a manner comparable to the facts of *BFI*." The Regional Director in the DDE further stated in this regard as follows:

> "Based on the record evidence, I view the scope of ACECO's involvement in determining the terms of employment for GJW employees assigned to its sites as not rising to the level of BFI's involvement in the terms of employment of Leadpoint employees. Furthermore, the record evidence indicates that much of ACECO's involvement is subject to the discretion of GJW, the general contractor and the hygienist at the work sites. Thus, I conclude there is an insufficient factual basis in this record for me to find that a joint-employer relationship exists between ACECO and GJW for the GJW employees assigned to work at ACECO work sites." *Green JobWorks*, at p. 9.
>
> The Regional Director relied on the following factors in reaching his conclusion:
>
> 1. Business Organization, Hiring, Transferring, Discipline, and Firing
>
> The evidence demonstrates that GJW and ACECO are separate business entities, with different management that independently set and pay wages, maintain payroll records, withhold payroll taxes and provide worker's compensation for their own employees. The independent relationship is embodied in the MLSA, which places all hiring, discipline and discipline authority within GJW's exclusive discretion. There is insufficient evidence in the record to support Petitioner's assertion that either company influences the decisions of the other with regards to essential terms and conditions of employment. However, there is sufficient evidence to establish that GJW solely makes these decisions regarding its employees with minimal input from ACECO. GJW recruits and hires the employees in the petitioned-for unit, and assigns those employees to the ACECO sites when its employees are offered and accept available positions at ACECO work sites. As in *BFI*¸ ACECO is not involved in interviewing or hiring GJW employees. Though ACECO can request specific GJW employees with particular skills and has done so, GJW is under no obligation to accede to any such request and provide particular employees.
>
> 2. Wages
>
> Unlike the facts in *BFI*, ACECO exercised limited influence on the wages of GJW employees. Citren testified that he did not know the rate of wages for GJW employees.
>
> 3. Daily Supervision
>
> In *BFI*, the Board found that supervisors exercised authority to hold meetings with Leadpoint employees to direct them to improve their performance. There is insufficient evidence in the record to establish that ACECO possessed or exercised comparable authority. Instead, the record shows that employee-wide

meetings were held for orientation purposes, and these trainings were run by the general contractor, and not ACECO.

On November 4, 2015, the Union filed a Request for Review of the Regional Director's Decision and Direction of Election, which is currently pending before the Board.

### C. NLRB Administrative Law Judge's December 17, 2015 Decision in *Campaign for the Restoration and Regulation of Hemp*

On December 17, 2015, NLRB Administrative Law Judge ("ALJ") Joel Biblowitz issued a decision in which he applied the Board's new joint employer standard as stated in *Browning-Ferris of California,* and found that three entities constituted a joint employer within the meaning of the NLRA.

The first entity was a nonprofit Oregon corporation that was involved in the promotion of medicinal and industrial hemp and cannabis. The second entity was also an Oregon nonprofit corporation and was involved in the cultivation and distribution of medical marijuana. The third entity was engaged in the business of operating clinics in several states to help patients obtain medical marijuana permits. The ALJ noted that the same individual founded the first two entities, and also served as President of all three entities. His duties included hiring employees of all three entities.

The ALJ, citing *Browning-Ferris of California,* reasoned as follows*:*

> The Board, in *BFI Newby Island Recyclery*, [*Browning-Ferris of CA*] 362 NLRB No. 186 (2015), reaffirmed the standard employed by the Third Circuit in *NLRB v. Brown-Ferris Industries of Pennsylvania, Inc.,* 691 F.2d 1117 (3d Cir. 1982), which stated: "Thus, the 'joint employer' concept recognizes that the business entities involved are in fact separate but that they *share* or co-determine those matters governing the essential terms and conditions of employment."
>
> The evidence (the affidavits) establishes that Stanford controls the labor relations of all three employers permitting meaningful collective bargaining, and they therefore constitute a joint employer within the meaning of the Act.

## V. SHOULD THE NLRB'S *OAKWOOD CARE CENTER* PRECEDENT BE OVERTURNED?

On July 6, 2015, the NLRB issued a Notice and Invitation to File Briefs in a case styled *Miller & Anderson, Inc.* (Case 05-RC-079249). In its Notice, the Board invited the parties in that case and interested *amici* to address one or more of the following questions:

1. How, if at all, have the Section 7 rights of employees in alternative work arrangements,

including temporary employees, part-time employees and other contingent workers, been affected by the Board's decision in *Oakwood Care Center*, 343 NLRB 659 (2004), overruling *M.B. Sturgis,* 331 NLRB 1298 (2000)?

2. Should the Board continue to adhere to the holding of *Oakwood Care Center*, which disallows inclusion of solely employed employees and jointly employed employees in the same unit absent the consent of the employers?

3. If the Board decides not to adhere to *Oakwood Care Center*, should the Board return to the holding of *Sturgis*, which permits units including both solely employed employees and jointly employed employees without the consent of the employers? Alternatively, what principles, apart from those set forth in *Oakwood* and *Sturgis*, should govern this area?

The *Miller & Anderson, Inc.* case is pending decision before the Board. Some commentators have suggested that the Board's decision in *Miller & Anderson* could be even more significant than the Board's decision in *BFI of CA*, due to the fact that the Board may create single bargaining units consisting of persons employed solely by separate firms and employed jointly by those firms. If the NLRB does overturn *Oakwood Care Center* and eliminates the employer consent requirement, it could clear the way for unions to organize on behalf of both jointly employed workers and regular, solely employed workers.

In its amicus brief filed in the *Miller & Anderson* case, the National Right to Work Legal Defense Foundation ("NRWLDF") has argued that the NLRA Section 7 rights of employees in alternative work arrangement ("contingent employees") are protected, not compromised, by the Board's decision in *Oakwood Care Center*. "*Oakwood Care Center* reversed a highly politicized and irrational decision, *M.B. Sturgis, Inc*., which overturned Board precedent of more than half a century…The *M.B. Sturgis* Board ignored the Act and prior Board caselaw to hold that a unit combining the user's employees with the supplier's employees performing all work for the user employer is not necessary to conduct a representation election and/or to bargain with a union."

The NRWLDF has further argued in its amicus brief that "under *Oakwood Care Center*, contingent employees referred to work for a user employer have the option of organizing along with the user employer's employees provided the supplier and user employer consent…. Alternatively, even as recognized by the *M.B. Sturgis* Board, contingent employees hired by a supplier employer can organize and engage in collective bargaining with the supplier employer. Absent employer consent for a joint employer unit with joint employer bargaining, a supplier employer and its employees would be placed into situations leading to fragmented bargaining and inherently conflicting interests inconsistent with the Act's principles."

## VI. NLRB GENERAL COUNSEL'S COMPLAINTS AGAINST MCDONALD'S AND ITS FRANCHISEES

In December 2014, the NLRB's Office the General Counsel issued 13 unfair labor practice complaints against McDonald's USA, LLC, McDonald's USA franchisees and/or McDonald's franchisees and their franchisor, McDonald's USA, LLC as alleged joint employers. [3]

The complaints allege that McDonald's USA, LLC and certain of its franchisees violated the rights of employees working at McDonald's restaurants at various locations around the country by, among other things, making statements and taking actions against them for engaging in activities aimed at improving their wages and working conditions, including participating in nationwide fast food worker protests about their terms and conditions of employment.

According to the NLRB's Office of Public Affairs, the NLRB's General Counsel seeks to hold McDonald's jointly liable with certain of its franchisees for alleged unfair labor practices of the franchisees, including "discriminatory discipline, reductions in hours, discharges, and other coercive conduct directed at employees in response to union and protected concerted activity, including threats, surveillance, interrogations, promises of benefit, and overbroad restrictions on communicating with union representatives or with other employees about unions and the employees' terms and conditions of employment."

Six more complaints asserting similar allegations against McDonald's USA LLC and its franchisees were issued by the NLRB's General Counsel on February 13, 2015.

McDonald's initially challenged the complaints on the grounds that they included no factual allegations to support the claim that McDonald's and its franchisees are joint employers, but simply allege: (1) the existence of a franchise agreement between McDonald's and each independent franchisee; (2) an unsupported assertion that McDonald's "possessed and/or exercised control over labor relations policies" of each franchisee; and (3) a legal conclusion that McDonald's is a joint employer. *See, e.g.*, ¶ 5 of the Consolidated Complaint Against ADJ, Inc., a McDonald's Franchisee and McDonald's USA, LLC, Joint Employers, et al., Case No. 02-CA-093895 and 02-CA-

[3] National Labor Relations Board ("NLRB") *NLRB Office of General Counsel Issues Consolidated Complaints Against McDonald's Franchisees and their Franchisor McDonald's USA, LLC as Joint Employers* (NLRB Office of Public Affairs, December 19, 2014) https://www.nlrb.gov/news-outreach/news-story/nlrb-office-general-counsel-issues-consolidated-complaints-against (last visited December 21, 2015).

097827, etc., filed before Region 2 of the National Labor Relations Board on December 19, 2014.[4]

McDonald's claimed that as a result of the General Counsel's failure to plead factual allegations in support of joint employer liability, McDonald's was left without adequate notice of the charges against it sufficient to prepare its defenses for trial.

An NLRB Administrative Law Judge, however, denied McDonald's above challenge, which was affirmed by the NLRB in a decision that issued on August 14, 2015. *McDonald's USA, LLC,* 362 NLRB No. 168 (2015). The NLRB, in a 3-2 decision, found that "the allegations in the complaint are sufficient to put McDonald's on notice that the General Counsel is alleging joint employer status based on McDonald's control over the labor relations policies of its franchisees."[5]

The NLRB's General Counsel has since sought to enforce certain subpoenas for documents that it served on McDonald's in proceedings before the United States District Court for the Southern District of New York. See e.g., *NLRB v. McDonalds, LLC,* Civil Action No. 1:15-mc-00322-P1. Accordingly, hearings before the NLRB Administrative Law Judges on all of the complaints have been temporarily postponed. A status conference before ALJ Esposito in New York is currently set for January 11, 2016.

## VII. NLRB GENERAL COUNSEL'S APRIL 28, 2015 ADVICE MEMO IN *FRESHI* CASE FINDING THAT FRANCHISEE AND FRANCHISOR WERE NOT JOINT EMPLOYERS

In a case preceding the issuance of the Board's decision in *BFI of CA*, the NLRB General Counsel's Division of Advice issued an Advice Memorandum on April 28, 2015 concluding that a restaurant franchisee was not a joint employer with its franchisor under <u>either</u> the Board's then current standard or under the joint employer standard that the NLRB's General Counsel was urging the Board to adopt in *BFI of CA,* and which the Board essentially did later adopt in its decision in *BFI of CA.. Nutritionality, Inc. d/b/a Freshi,* Office of the General Counsel, Advice Memorandum No. 177-1650-0100 (Cases 13-CA-134294, 138293 & 142297) (April 28, 2015) (A copy is attached under Tab 2).

Applying the General Counsel's proposed joint employer standard (essentially adopted by the Board in *BFI of CA*), the GC's Division of Advice concluded that Freshi

[4] This complaint names McDonald's USA and twelve of its independent franchisees as respondents in the alleged unfair labor practice charges. Additional complaints have been filed against McDonald's and its franchisees in Regions 4 (Philadelphia), 7 (Detroit), 10 (Atlanta), 13 (Chicago), 14 (St. Louis) and Subregion 17 (Kansas City), 15 (New Orleans), 18 (Minneapolis), 20 (San Francisco), 25 (Indianapolis), 28 (Phoenix), and 31 (Los Angeles). All of the complaints and other pleadings in the case are available on the NLRB's website at www.nlrb.gov.

[5] Board Members Miscamarra and Johnson dissented, noting that the "complaint language provides no notice regarding the new joint employer standard upon which the General Counsel intends to rely in the alternative, nor what facts the General Counsel believes will prove joint employer status under the alternative standard." Notably, this decision preceded the issuance of the NLRB's August 27, 2015 decision in *Browning-Ferris of CA*.

(the franchisor) and Nutrionality (the franchisee) were not joint employers of Nutritionality's employees, reasoning as follows:

> "Freshi does not significantly influence the working conditions of Nutritionality's employees. For example, it has no involvement in hiring, firing, discipline, supervision or setting wages. Thus, because Freshi does not directly or indirectly control or otherwise restrict the employees' core terms and conditions of employment, meaningful collective bargaining between Nutritionality and any potential collective-bargaining representative of the employees could occur in Freshi's absence."

## VIII. EFFECT OF NLRB'S NEW JOINT EMPLOYER STANDARD ON EXISTING BUSINESS OPERATIONS AND SUGGESTED EMPLOYER ACTIONS

In view of the NLRB's decision in *BFI of CA*, employers may wish to consider some of the following actions:

- Review the employer's current business model to determine whether changes can be made to reduce the potential for a finding of joint employer status, e.g., consider whether is it really cost effective to outsource certain functions in light of the risk that the employer may be a joint employer with that company for purposes of liability for unfair labor practices or negotiating collective bargaining agreements.

- Review commercial agreements, leases, licenses, franchise agreements, etc. to ensure that none include, even inadvertently, language that suggests that the employer retains the ability to exercise control over another's business operations.

- Review the employer's current business methods to ensure that the employer (or its managers) are not exercising direct and immediate control over the terms and conditions of employment of workers employed by franchisees, subcontractors, or other business partners.

- Revise contracts and other commercial agreements to ensure that they clearly provide that franchisees, subcontractors, or other business partners are solely responsible for all employment-related decisions.

- Implement procedures to ensure that the maximum amount of operational control over day-to-day business operations is in the hands of the franchisee, subcontractor, or other business partners, and that the managers of both parties understand that.

# TAB 1

**UNITED STATES OF AMERICA**
**BEFORE THE NATIONAL LABOR RELATIONS BOARD**
**REGION FIVE**

GREEN JOBWORKS, LLC/ACECO, LLC
(A JOINT EMPLOYER)

Employers

and Case 05-RC-154596

CONSTRUCTION AND MASTER LABORERS'
LOCAL UNION NO. 11

Petitioner

## DECISION AND DIRECTION OF ELECTION

Upon a petition duly filed under Section 9(c) of the National Labor Relations Act ("the Act"), as amended, a hearing was held on July 2 and 6, 2015 before a hearing officer of the National Labor Relations Board ("the Board").[1] The Construction and Master Laborers' Local Union 11, affiliated with Laborers' International Union of North America ("Petitioner") filed the petition seeking to represent a unit of employees jointly employed by Green JobWorks ("GJW") and ACECO, LLC ("ACECO"), comprised of "all full-time and regular part-time laborers, including demolition and asbestos removal workers employed by the joint employer, but excluding office clericals, confidential and management employees, guards, and supervisors under the Act."

The parties stipulated, and I find, that Petitioner is a labor organization within the meaning of Section 2(5) of the Act, that GJW and ACECO are employers engaged in commerce within the meaning of Section 2(6) and (7) of the Act,[2] and that all parties are therefore subject to the jurisdiction of the Board.

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[1] In light of the Board's August 27, 2015 decision in *Browning-Ferris Industries of California, Inc.*, 362 NLRB No. 186 (2015), the Region solicited supplemental briefs from the parties in response to the decision. Petitioner and ACECO filed supplemental briefs.

[2] The parties stipulated, and I find, that Green JobWorks, LLC has been a limited liability company with an office and place of business in Baltimore, Maryland, and has been engaged in business as a temporary staffing agency engaged in the business of demolition and environmental remediation, including asbestos remediation. In conducting its operations during the previous 12 months, Green JobWorks, LLC performed services valued in excess of $50,000 in states other than the State of Maryland.

## I. ISSUES AND POSITIONS OF THE PARTIES

There were three principal issues presented at the hearing: (1) whether GJW and ACECO constitute a joint employer under the Act; (2) whether a unit of all GJW employees working on an ACECO worksite is appropriate; and (3) whether all other GJW employees at non-ACECO sites share an overwhelming community of interest with the petitioned-for employees.[3] In the event that I do not find that a joint employer relationship, Petitioner indicated it was willing to proceed to an election for a unit consisting of GJW employees assigned to ACECO worksites.

On the first issue, Petitioner's position is that GJW and ACECO have a joint employer relationship. Petitioner relies upon the Board's recent decision in *Browning-Ferris Industries of California, Inc.*, 362 NLRB No. 186 (2015) ("*BFI*").[4] In *BFI*, the Board restated its joint-employer standard, holding that two or more entities will be considered joint employers of a single work force if: (1) there is a common-law employment relationship with the employees in question; and (2) the putative joint employer possesses sufficient control over employees' essential terms and conditions of employment to permit meaningful collective bargaining. *BFI,* 362 NLRB No. 186. at slip op. 2. According to the Petitioner, the facts in *BFI* are indistinguishable from the instant case, as evidenced by ACECO's overwhelming influence over discipline, overtime, layoffs, and direction of work. GJW and ACECO deny that they are joint employers. According to ACECO, the petition should be dismissed because the present facts are fundamentally different from *BFI*, namely ACECO's lack of ownership over the project sites, and its lack of control over the site and GJW employees.

Regarding the second issue, Petitioner's position is that if no joint-employer relationship is found, a unit of GJW employees at ACECO sites is an appropriate unit. However, GJW and ACECO both argue that such would not be an appropriate unit, but that there is an overwhelming community of interest between all asbestos and demolition employees employed by GJW in the greater Washington, D.C. metropolitan area and that such is the appropriate unit. Tied in with the last issue, Petitioner maintains that GJW and ACECO failed to meet their burden of establishing an overwhelming community interest of the additional employees it seeks to add to

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[3] In addition to these substantive issues, Petitioner alleges that ACECO failed to comply with its subpoena *duces tecum* because it provided electronic copies of the required documents, rather than paper copies. Petitioner thus seeks reimbursement for $367.66 it incurred in printing expenses. I find that ACECO complied with the subpoena as requested, and deny the motion for reimbursement.

[4] At the time of the hearing, the Board had not issued *BFI*; thus, Petitioner's original argument on the issue was that the evidence at the hearing established that ACECO was a joint employer of GJW employees working at its sites because ACECO meaningfully affected the conditions of employment for the employees in the petitioned-for unit, as under *Laerco Transportation*, 269 NLRB 324 (1984). In *BFI*, the Board explicitly overruled *Laerco* to the extent its formulation of the joint-employer standard was inconsistent with the standard provided in *BFI*.

the unit, namely, all of GJW's employees working at non-ACECO sites in the greater Washington, D.C. metropolitan area.

## II. BACKGROUND AND FACTS

### A. Overview Of GJW's Operations

GJW is a staffing company that provides temporary labor to various construction companies.[5] Specifically, GJW provides demolition and asbestos abatement laborers to approximately 15 to 20 client construction companies, including ACECO.[6] Companies performing asbestos removal in Maryland, Virginia, or Washington, D.C. must be licensed, and GJW is not licensed to perform asbestos removal in Maryland, Virginia, or Washington, D.C. At the time of the hearing, GJW was responsible for providing labor to eight different projects.

GJW primarily recruits new employees through advertisements and word-of-mouth-referrals. All applicants for employment must pass a drug-screening exam. If an applicant is applying for a demolition position, he must pass a safety and general knowledge test for demolition. After a drug-screening exam and general knowledge test has been completed, the individual completes an application, and GJW enters the individual's information into its database until a position becomes available.

Before assigning an employee to a particular site, GJW examines his credentials to ensure that the employee is licensed. GJW reimburses the employee for his license renewal fees if GJW assigns the employee to a site when the employee's license is up for renewal. GJW also provides training, including videos, discussions on policies and procedures in the GJW handbook regarding conduct on a job site, and safety protocols. In addition to the training, GJW tests an employee to assess his skill set, and ability to use tools that will be required on the job.

When a position becomes available, GJW contacts qualified employees in its database to offer them the position. Each employee is told the assigned wage rate for the job, and has the option to accept or reject the position. The wage rate is based on GJW's contractual relationship with the particular client, or set rates for government jobs. According to GJW's president, Larry

[5] The parties stipulated, and I find, that ACECO, LLC has been a limited liability company with an office and place of business in Spring, Maryland, and has been engaged in the business of providing demolition, environmental remediation and renovation services to private and governmental entities in Maryland, Washington, D.C. and Virginia. In conducting its operations during the 12-month period ending June 1, 2015, ACECO performed services valued in excess of $50,000 in States other than the State of Maryland.

[6] Asbestos abatement refers to the removal of asbestos, a hazardous material, from buildings.

Lopez, GJW employees assigned to an ACECO site can work overtime only when ACECO gives GJW confirmation that GJW can bill ACECO for the overtime hours of GJW's employees.

GJW has an evaluation process to determine whether an employee should receive a wage increase, based on that employee's length of service and previous performance. GJW clients such as ACECO are not involved in this evaluation, or in setting the wage rate that GJW pays its employees. GJW offers benefits to its employees, such as health insurance and paid time off.

GJW field supervisor Juan Rodriguez is responsible for traveling to each project site to interact with lead employees and individual client supervisors to ensure that GJW employees have reported to work. Rodriguez is also responsible for relaying information from the GJW office to its employees at the project sites, as well as information from the client supervisors back to GJW. Rodriguez, GJW recruiting manager Alexander Miranda, GJW and clerical employee Carlos Guzman collectively determine when a GJW employee is to be reassigned to another project site.

While on ACECO sites, GJW employees are required to sign in with GJW's lead employees every day.[7] A GJW lead employee typically takes a picture of the sign-in sheet, and sends it to GJW field supervisor Rodriguez, who the submits it to GJW for payroll processing.

While ACECO is able to request particular employees with the desired skill set by name, GJW is not obligated to comply with the request. Lopez testified that ACECO had requested employees by name in the past because it was easier than asking for a certain number of employees with the desired skill set.

### B. Overview Of ACECO's Operations

ACECO is a licensed demolition and environmental remediation contractor. ACECO primarily deals with asbestos removal, but it also occasionally removes mold and lead paint. ACECO employs its own workforce, and supplements its workforce with GJW employees assigned to ACECO's work sites. ACECO provides its employees with benefits, such as a 401(k) plan and paid time off.

ACECO's president, Michael Citren, testified that ACECO's work schedule at any given work site is set by its client, the general contractor or the owner of the site where ACECO is contracted to work. At each site where ACECO is contracted, the general contractor for the project employs a supervisor who is responsible for the general safety and coordination of the site. According to Citren, ACECO's supervision of the site is restricted and subject to the general contractor's instructions. ACECO does not have the authority to go onto the site without permission from the general contractor or owner. For certain jobs, the general contractor

[7] No party asserts that GJW lead employees are supervisors under Section 2(11) of the Act.

provides site orientation to employees assigned to work at the particular site. Citren testified that the orientation is considered a prerequisite to work on the site.

For asbestos abatement jobs, a hygienist is hired to ensure safety in the asbestos removal process. Depending on the site, the hygienist is hired by ACECO as an independent contractor, or by the building owner. According to Citren, the hygienist serves as an additional layer of oversight over workers at the sites by stepping in to direct employees in order to avoid safety violations.

### C. Details Of The Relationship Between GJW and ACECO

ACECO engaged GJW to provide asbestos abatement and demolition workers to its jobsites sometime in 2012. For the first half of 2015, GJW provided labor on 26 ACECO projects. At the time of the hearing, there were four to eight ACECO work sites at which GJW employees were assigned.

When GJW receives a request for laborers from ACECO, it refers to its database to determine which available employees match the requested skill set. GJW sends the selected employees to the ACECO site until it receives notice that a particular assignment is finished, or that a skill set is no longer needed. On occasion, an ACECO representative has contacted GJW representatives and asked GJW to send particular employees, and refrain from sending others. Lopez testified that these requests were based on the skill set of the employees, and the fact that the employees had already been oriented and trained to work on the particular projects. In the event of an unplanned work stoppage on an ACECO site, GJW is responsible for reassigning its employees, while ACECO independently reassigns its employees. GJW employees that have been assigned to ACECO sites in the past do not need to request permission from ACECO before working for one of ACECO's competitors.

On May 8, 2015, GJW and ACECO entered into a Master Labor Services Agreement with a Subcontract Addendum ("the MLSA"). Under the terms of the MLSA, GJW must provide lead workers at ACECO work sites where GJW employees are assigned. These lead employees are tasked with documenting and tracking GJW employee hours, determining breaks and rest periods, and removing GJW workers from the site, if necessary. The MLSA also reinforces GJW's exclusive responsibilities regarding its employees:

a) Recruiting, hiring, assigning, orienting, reassigning, counseling, disciplining, and discharging the Employees.

b) Making legally-required employment law disclosures (wage hour posters, etc.) to them.

c) Establishing, calculating, and paying their wages and overtime.

d) Exercising human resources supervision of them.

e) Withholding, remitting, and reporting on their payroll taxes and charges for programs that GJW is legislatively required to provide (including workers' compensation).

f) Maintaining personnel and payroll records for them.

g) Obtaining and administering I-9 documentation of employees' right to work in the United States.

h) Paying employees' wages and providing the benefits that GJW offers to them.

i) Paying or withholding all required payroll taxes, contributions, and insurance premiums for programs that GJW is legislatively mandated to provide to employees as GJW's employees.

j) Providing workers' compensation benefits or coverage for employees in amounts at least equal to what is required by law.

k) Fulfilling the employer's obligations for unemployment compensation.

l) Complying with employment laws, as they apply to GJW.

The MLSA also stipulates that GJW can pay an additional wage premium to each GJW crew leader tasked with supervising GJW employees at ACECO's work sites, including tracking the attendance of GJW employees. Lopez and Citren both testified that GJW sets the rate of pay for its employees, without input from ACECO. Under the MLSA, GJW and ACECO are prohibited from soliciting the other's employees.

In addition, GJW provides its employees with hardhats, safety vests, safety glasses, steel-toed boots, respirators, and filters. ACECO provides its own employees with the listed items, but does not provide such items to GJW employees. Once at the site, ACECO provides replacement filters (for respirators) and special Tyvek suits (for asbestos containment areas) to both GJW and ACECO employees.

During the hearing, Petitioner sought to elicit evidence concerning day-to-day episodes involving GJW employees working at ACECO work sites. Regarding one particular incident in which GJW considered substituting one employee for another because of the employee's prior conflict with an ACECO supervisor, Lopez was unable to provide details about a text message exchange between GJW and ACECO supervisors because he was not involved. However, Lopez testified that GJW tries to avoid issues with its clients while providing the best workforce that can do the job.

In another distinct incident, an ACECO representative sent a GJW employee home early for going into a known restricted area without permission. An ACECO representative informed a GJW representative that it sent the employee home, and asked that the GJW employee not return to that particular site until further notice. The GJW representative informed the ACECO representative that it would address the issue immediately. Lopez acknowledged the incident and described his understanding that ACECO's client, the general contractor, imposed the restriction, and ACECO appropriately relayed the message to GJW.

Regarding a separate occurrence, an ACECO representative sent a text message to a GJW representative, stating, "FYI, this morning around 10am, we send home one of your labors [sic] due not performing with the work and was no found at this work area, our Foreman and GC [general contractor] were looking for him for 20 minutes. So we do not need him back tomorrow. Thanks." According to the text message exchange that followed, the GJW representative asked for the name of the employee, and asked if ACECO needed a replacement. However, Lopez was unaware of the incident and could not provide any information about it during the hearing. ACECO's president, Michael Citren, acknowledged that the GJW employee in question was sent home at the direction of ACECO's client, the general contractor, because the employee committed a safety violation.

Petitioner asked Lopez about another occasion, in which it appeared that a GJW representative asked an ACECO representative by text message whether it would transfer a GJW employee from demolition work to asbestos work. Lopez was unaware of the situation, and testified that he was confused by the text message exchange. He maintained that ACECO did not have the power to transfer GJW employees, but could discuss the need to move employees from one area to another with GJW if the need arose. Citren similarly testified that GJW was not required to terminate or discipline an employee that had been removed from an ACECO jobsite.

Petitioner asked Lopez about a text message exchange in which an ACECO supervisor complained to a GJW representative about a GJW employee showing up to a work site when he should not have. The GJW representative responded, "Alexander spoke with him today and told him specifically not to go to work I'm so sorry about this."[8] In another responsive text message to the ACECO representative, the GJW representative indicated that the GJW employee had been informed to not go to the work site, and that GJW would terminate that employee. When asked about this incident, Lopez was unaware of it and could not provide any testimony about the facts.[9] Lopez added that Petitioner's interpretation of the text did not account for other potentially relevant facts, such as the employee's record prior to the termination.

Arturo Campos, a GJW employee, testified that in his three-year tenure with GJW, 90 percent of his assignments have been at an ACECO work site. Campos also stated that an ACECO supervisor usually gave him his daily tasks. In addition, he had never seen an ACECO supervisor send a GJW employee home, though he witnessed several instances in which a GJW supervisory employee sent a GJW employees home. Campos testified that the only discipline he

[8] Presumably, "Alexander" refers to Alexander Miranda, GJW's recruiting and staffing manager.
[9] No other witness was presented to discuss this incident.

had received while working for GJW was from Lopez, and that he had not received any discipline from an ACECO supervisor.

## III. ANALYSIS

As explained below, I conclude that: (1) there is insufficient evidence to establish that GJW and ACECO are joint employers; (2) a unit of solely GJW employees at ACECO work sites is an appropriate unit; and (3) there is insufficient evidence to demonstrate an overwhelming community of interest among all GJW employees in the greater Washington, D.C. metropolitan area that warrants an expansion of that unit.

### A. There Is Insufficient Evidence To Establish That GJW And ACECO Are Joint Employers

The Petitioner did not meet its burden of introducing specific, detailed and relevant evidence into the record for me to find that ACECO is a joint employer of the GJW employees in the petitioned-for unit. To establish a joint employer relationship, "the initial inquiry is whether there is a common-law employment relationship with the employees in question." *BFI,* 362 NLRB No. 186, at slip op. 2 (2015). If the common-law employment relationship exists, then the inquiry turns to "whether the putative joint employer possesses sufficient control over employee's essential terms and conditions of employment to permit meaningful collective bargaining." *Id*. The Board no longer requires that a joint employer possess and exercise the authority to control employees' terms and conditions. Rather, the Board identified that the putative employer's "[r]eserved authority to control terms and conditions of employment, even if not exercised," is probative of a joint-employer relationship, as is the actual exercise of that control. *Id.* at slip op. 2, 16. The Board includes subjects such as hiring, firing, discipline, supervision and direction as "essential terms and conditions of employment," but the Board stated that it would recognize other examples of terms and conditions of employment in conducting a joint-employer analysis. *Id.* at slip op. 15

In the recently-decided *BFI* , the Board examined the existence of the relationship between Browning-Ferris Industries of California (BFI), a recycling facility operator, and Leadpoint, the staffing agency that provided labor to BFI. The Board determined that BFI and Leadpoint were joint employers, despite the existence of a temporary labor services agreement between the parties that stated otherwise. Although Leadpoint recruited, interviewed, and administered tests to its employees, the Board found that BFI still possessed significant control over who Leadpoint could hire to work at BFI's facility. One of the clauses in the labor services agreement between the two entities gave BFI the unqualified right to reject any Leadpoint-referred worker for "any or no reason." The Board deemed this power to be clear evidence that BFI exercised significant control over Leadpoint's hiring decisions. The Board also relied upon two specific instances in which a BFI representative reported to Leadpoint the misconduct of a

Leadpoint employee and requested their immediate dismissal. Leadpoint complied with BFI's requests and dismissed the employees, demonstrating the depth of BFI's influence over Leadpoint's workforce.

Regarding day-to-day supervision and management, BFI managers had the power to counsel Leadpoint employees regarding their productivity. BFI also had the power to assign specific tasks to Leadpoint employees, as well as to hold meetings to address customer complaints and business objectives. In sum, the Board found that BFI exercised "near-constant oversight" over the Leadpoint employees. The Board noted that BFI's communicating of its directives through Leadpoint supervisors still evinced clear control over the employees by BFI, indicative of an employer-employee relationship.

Finally, the Board found that BFI played a significant role in determining the wages of Leadpoint employees. While Leadpoint had the authority to determine the pay rates for its employees, its authority was constrained by its labor services agreement with BFI. Under the terms of that agreement, Leadpoint could not pay its employees more than BFI paid its own employees for comparable work. The Board found that the sharing and codetermining of terms and conditions established that BFI and Leadpoint were joint employers of the employees in question.

Applied to the facts of the case before me, I conclude that the Petitioner failed to establish by specific, detailed evidence that ACECO had the authority to control matters governing the essential terms and conditions of GJW employees in a manner comparable to the facts of *BFI*. Based on the record evidence, I view the scope of ACECO's involvement in determining the terms of employment for GJW employees assigned to its sites as not rising to the level of BFI's involvement in the terms of employment of Leadpoint employees. Furthermore, the record evidence indicates that much of ACECO's involvement is subject to the discretion of GJW, the general contractor and the hygienist at the work sites. Thus, I conclude there is an insufficient factual basis in this record for me to find that a joint-employer relationship exists between ACECO and GJW for the GJW employees assigned to work at ACECO work sites.

1. **Business Organization, Hiring, Transferring, Discipline, and Firing**

The evidence demonstrates that GJW and ACECO are separate business entities, with different management that independently set and pay wages, maintain payroll records, withhold payroll taxes and provide worker's compensation for their own employees. The independent relationship is embodied in the MLSA, which places all hiring, discipline and discipline authority within GJW's exclusive discretion. There is insufficient evidence in the record to support Petitioner's assertion that either company influences the decisions of the other with regards to essential terms and conditions of employment. However, there is sufficient evidence to establish that GJW solely makes these decisions regarding its employees with minimal input from ACECO. GJW recruits and hires the employees in the petitioned-for unit, and assigns those employees to the ACECO sites when its employees are offered and accept available positions at ACECO work sites. As in *BFI*¸ ACECO is not involved in interviewing or hiring GJW employees. Though ACECO can request specific GJW employees with particular skills and has done so, GJW is under no obligation to accede to any such request and provide particular employees. I do not share Petitioner's conclusion that certain text messages sent by ACECO representatives to GJW representatives that suggest a request for certain specific GJW employees establishes that ACECO has the right to control GJW's hiring decisions. Rather, I conclude that there is insufficient evidence to demonstrate that ACECO possessed or exercised the level of control identified in *BFI*.

While Petitioner attempted to demonstrate that the ACECO had the authority to transfer GJW employees from one assignment to another or to remove an employee, I do not view the evidence as supporting this assertion. Instead, the record shows that the instances in which GJW employees were sent home by non-GJW representatives were based on directives from ACECO's client, the general contractor, rather than ACECO's itself. In one instance, a GJW employee went into a restricted area, and ACECO's general contractor asked that the employee be sent home for violating safety precautions and explicit instructions. In turn, ACECO asked GJW to keep the employee in question from returning to that particular work site until further notice, as ACECO was instructed by its general contractor. According to Lopez, GJW's president, GJW complied with the general contractor's request. In another instance, ACECO's general contractor and an ACECO foreman searched for a GJW employee for 20 minutes when that employee should have been on duty. Citren, ACECO's president, testified that the general contractor directed that this employee be sent home. With this limited record evidence, I conclude that there is insufficient evidence in the record to establish that ACECO, in its sole discretion, possessed or exercised transfer or disciplinary authority over GJW employees.

Petitioner also posits that ACECO can request not to have specific GJW employees work at its site because of personality issues with ACECO workers. To support this assertion, Petitioner introduced text messages in which a GJW representative offered to send a replacement employee to an ACECO site because the initial employee "had some issues with [a] supervisor" in the past. The record evidence shows that while GJW was open to accommodating ACECO's preferences regarding the employee, GJW had final discretion. On this limited evidence, I am not willing to conclude that ACECO possesses the authority Petitioner contends that ACECO has over GJW's employees.

The MLSA between ACECO and GJW grants ACECO the "right to direct GJW management and/or supervisory personnel to dismiss from the job site/location any GJW staff member for safety issues or any other reasonable objections to such staff members remaining on site." In *BFI*, the Board noted BFI's power to reject any personnel and discontinue the use of any personnel for "any reason." However, ACECO's right to refuse a GJW employee for safety violations or other *reasonable* objections does not rise to the level of BFI's unqualified right of refusal. That said, this authority, as indicated in the MLSA, is arguably an element within ACECO's control that favors a finding of a joint employer relationship.

Regarding the authority to terminate GJW employees, Petitioner did not introduce evidence comparable to the facts in *BFI*, where BFI possessed and exercised the power to request the immediate dismissal of employees. Rather, the record indicates that ACECO does not have the authority to do so, nor is there any indication that ACECO had exercised such a right. To support its assertion that ACECO possessed the authority to terminate the employment of a GJW employee, Petitioner refers to a text message exchange in which an ACECO representative asked a GJW representative for an explanation regarding an employee that had reported to the site. According to the response from the GJW representative, that employee had been specifically instructed by GJW to not report to that site. The record does not provide any supporting details to explain why the GJW employee was not supposed to be at the site, or who had requested the prohibition in the first place. Furthermore, the evidence does not indicate that ACECO was demanding that GJW terminate the employee, but rather that GJW explain the employee's presence. The record is vague on the circumstances that precipitated the incident, but it is clear that GJW had previously informed the employee to not report to the site, and the employee violated GJW's instruction. Without more information about the circumstances of this incident, I do not view it as rising to the level in *BFI*, in which BFI sent an e-mail to Leadpoint requesting immediate dismissal of employees. There is little indication in the record that ACECO possessed or exercised control over the termination decision for the employee in question.

**2. Wages**

Unlike the facts in *BFI*, ACECO exercised limited influence on the wages of GJW employees. Citren testified that he did not know the rate of wages for GJW employees. Petitioner seems to posit that ACECO controls the wages of GJW employees when it negotiates with GJW the contract price for each project. Based on the contract between the parties, GJW charges ACECO a set amount per hour for different tasks to be completed by GJW employees. Under such a contractual arrangement, Petitioner seems to argue that ACECO controls the authority of the wage rate for GJW employees because, in effect, ACECO is reimbursing GJW for the wages that GJW pays its employees. As a practical consideration, I assume the argument is that ACECO thus possesses control over the GJW employees' wage rate because GJW will not pay its employees a wage rate if more than GJW can charge to ACECO. However, Lopez testified that GJW employees had the power to individually negotiate a higher wage by demonstrating a stellar job performance record and other relevant factors. Lopez indicated that some GJW employees had done this successfully. Thus, I conclude that there is insufficient evidence in the record to determine what rates ACECO employees receive, in comparison to GJW employees. There is similarly insufficient evidence to determine whether any GJW employee has ever negotiated a wage higher than an ACECO employee makes for comparable work. Unlike the agreement in *BFI*, the MLSA between ACECO and GJW does not specifically prohibit GJW from paying its employees more than ACECO pays its employees for comparable work. Therefore, ACECO's authority over the wages of GJW's employees in wage setting is not comparable to BFI's influence on the wages of Leadpoint employees. This factor cuts against a joint employer finding.

### 3. Daily Supervision

Arturo Campos, a GJW employee familiar with ACECO sites, testified that GJW sends employees home, sets the employees' schedules, and informs the employees of their next client project. This supports GJW and ACECO's position that ACECO has minimal involvement in terms and conditions of employment of GJW employees. Other than Campos's claim that he received instructions about day-to-day tasks from ACECO supervisors, most of his testimony supported the position that GJW made most of the substantive decisions surrounding the terms and conditions of his employment. Furthermore, there is insufficient evidence on the record to address whether Campos continued to receive day-to-day instructions from ACECO after the execution of MLSA and the Addendum in May 2015. Thus, Campos' claims regarding the level of daily supervision by ACECO supervisors could concern the time period prior to the effective date of the MLSA.

In *BFI*, the Board found that supervisors exercised authority to hold meetings with Leadpoint employees to direct them to improve their performance. There is insufficient evidence in the record to establish that ACECO possessed or exercised comparable authority. Instead, the record shows that employee-wide meetings were held for orientation purposes, and these trainings were run by the general contractor, and not ACECO.

Campos testified that ACECO supervisors assign his daily tasks. However, the record fails to show that ACECO's supervision includes showing the GJW employees how to work. Unlike the *BFI* decision, in which the Board found clear evidence of direct and constant oversight, the instant record shows that ACECO exercised minimal supervision over GJW employees. The general contractor and hygienist had more supervisory authority than ACECO supervisors. For example, Citren testified that the day-to-day schedule was set by the general contractor, and not ACECO. Even ACECO employees were not authorized to be on jobsites without permission the general contractor.

In contrast, in *BFI*, the managers exercised "near-constant oversight" over Leadpoint employees. BFI supervisors assigned employees to specific tasks and counseled them about their job performance as needed. There is little indication that ACECO exercised this level of oversight over GJW employees directly or indirectly. During his testimony, Campos indicated that he largely worked autonomously on ACECO jobsites, given his level of experience. The varying element of control exercised by BFI and ACECO over the leased employees further cuts against a finding of joint employer.

### 4. The Appropriateness of ACECO's Participation in Bargaining

Petitioner argues that ACECO is a necessary party to any collective-bargaining discussions because ACECO exerts so much influence over GJW employees. In contrast, ACECO argues that Petitioner failed to meet its burden of showing that ACECO had sufficient control over the employees to allow "meaningful collective bargaining." ACECO draws a distinction between the facts of *BFI* and the record evidence on ACECO's level of control over "bargainable issues." In *BFI*, the Board determined that BFI had ultimate control over bargainable issues such as break times, safety, the speed of work, and the productivity of Leadpoint employees. ACECO argues that there is clear evidence in the record to establish that ACECO does not have control over any of these issues regarding GJW employees.

I find that ACECO is correct in this regard. The record evidence indicates that the schedule is set by the general contractor, who has ultimate control over the work sites. Regarding safety issues, the record demonstrates that the hygienist, rather than ACECO, has more input on safety measures. According to Citren, the general contractor hires the hygienist for some site, and that occasionally ACECO hires a hygienist as an independent contractor. ACECO supervisors defer to the hygienist regarding safety concerns on the work site. As for the breaks and the productivity of GJW employees, the MLSA between ACECO and GJW assigns that power to lead GJW employees, rather than ACECO. As such, there is little record support for the argument that ACECO has ultimate control that is probative of an employment relationship such that it would warrant ACECO's involvement in collective-bargaining.

Accordingly, I find that the Petitioner did not meet its burden of establishing by specific, detailed evidence that ACECO is a joint employer of the GJW employees. Nevertheless, for reasons set forth below, I find that an alternative unit of workers solely employed by GJW at ACECO sites is an appropriate unit.

### B. There Is Sufficient Evidence To Demonstrate That The Alternative Petitioned-For Unit Of Solely Green JobWorks Employees At ACECO Work sites Share A Community Of Interest, And Is Thus An Appropriate Unit.

I find that a petitioned-for unit,[10] modified to include GJW as the sole employer, and limited in scope to those GJW employees assigned to ACECO work sites is an appropriate unit.

The Board's procedure for determining an appropriate unit under Section 9(b) is to examine first the petitioned-for unit. If that unit is appropriate, then the inquiry into the

[10] At hearing, Petitioner indicated it was willing to proceed to an election for an alternative unit.

appropriate unit ends. *Overnite Transp. Co.*, 331 NLRB 662, 663 (2000). The petitioned-for unit does not need to be the *only* appropriate unit, or even the *most* appropriate unit, but merely *an* appropriate unit. *See Overnite Transportation Co.*, 322 NLRB 723, 723 (1996).

To determine whether the proposed unit is an appropriate unit, the Board's focus is on whether the employees share a "community of interest." *Specialty Healthcare & Rehabilitation Center of Mobile*, 357 NLRB No. 83, slip op. at 14 (2011), citing *NLRB v. Action Automotive, Inc.*, 469 U.S. 490, 491 (1985). In determining whether employees in a proposed unit share a community of interest, the Board examines:

> [W]hether the employees are organized into a separate department; have distinct skills and training; have distinct job functions and perform distinct work, including inquiry into the amount and type of job overlap between classifications; are functionally integrated with the Employer's other employees; have frequent contact with other employees; interchange with other employees; have distinct terms and conditions of employment; and are separately supervised.

*Id.* at 9. "[T]he manner in which a particular employer has organized his plant and utilizes the skills of his labor force has a direct bearing on the community of interest among various groups of employees in the plant and is thus an important consideration in any unit determination." *International Paper Co.*, 96 NLRB 295, 298, n.7 (1951).

An appropriate unit is not rendered inappropriate by the mere fact that its employees share a community of interest with additional employees outside the unit. *Specialty Healthcare*, supra, at slip op. 15 (Aug. 26, 2011). Thus, "demonstrating that another unit containing the employees in the proposed unit plus others is appropriate, or even that it is more appropriate, is not sufficient to demonstrate that the proposed unit is inappropriate." *Id.* Instead, "both the Board and courts of appeals have necessarily required *a heightened showing* to demonstrate that the proposed unit is nevertheless inappropriate because it does not include additional employees." *Id*. (emphasis added). Specifically, the employer must show, using the traditional community-of-interest factors, "that employees in the larger unit share an overwhelming community of interest with those in the petitioned-for unit." *Id*. at slip op. 17.

Here, I find that a unit of GJW employees working at ACECO sites is an appropriate unit because the employees are a readily-identifiable group and share a community of interest. That the unit is readily identifiable is self-evident—it is all of GJW's employees working for a particular contractor. Furthermore, no party contends that such a unit is not readily identifiable. As for the second portion of the inquiry, the record evidence is sufficient for me to find that these employees have a community of interest. They are all licensed asbestos-abatement workers that work for GJW on ACECO projects.

Pursuant to the MLSA supervisory structure, GJW employees at ACECO sites are supervised by GJW lead workers who all report to a GJW representative, Juan Rodriguez. The record demonstrates that the recently-memorialized arrangement in which GJW lead workers are paid an additional wage is currently limited to employees at ACECO sites. Therefore, there appears to be a common supervisory structure in place, meeting that community of interest factor. Employees at ACECO sites share common skills and job duties, common work sites and working conditions, as well as common supervision. I thus find that GJW employees working at ACECO sites constitute an appropriate unit.

As GJW is engaged in the construction industry and the record reflects that the number of unit employees varies from time to time, the eligibility of voters will be determined by the formula set forth in *Daniel Construction Co.*, 133 NLRB 264 (1961) and *Steiny & Co.*, 308 NLRB 1323 (1992).

**C. There Is Insufficient Evidence To Demonstrate An Overwhelming Community Of Interest Among All GJW Employees That Warrants An Expansion Of the Petitioned-For Unit.**

When a petition seeks a unit of employees who are readily identifiable as a group (based on job classifications, departments, functions, work locations, skills or similar factors), and the employees in the group share a community of interest under the traditional criteria, the burden of proof is on the proponent of a larger unit to demonstrate that the additional employees it seeks to include share an "overwhelming community of interest" with the petitioned-for employees, such that there "is no legitimate basis upon which to exclude certain employees from" the larger unit because the traditional community-of-interest factors "overlap almost completely." *Odwalla, Inc.* 357 NLRB No. 132, slip op. at 4 (December 9, 2011); *Specialty Healthcare*, supra, slip op. at 11-13 and fn. 28. The crux of the argument as to why the GJW employees working at non-ACECO work sites share an overwhelming community of interest with the GJW working at ACECO sites is that there is no record evidence indicating that the included employees have any skills, training, or other terms and conditions of employment that is at all distinct from the excluded employees.

As discussed above, pursuant to the MLSA, the GJW employees at ACECO sites now have a formally-designated lead worker who acts as the point of contact to Juan Rodriguez, the GJW field supervisor. The lead workers are specially trained for the position and paid more money than the other employees. These employees submit daily timesheets to GJW at the end of each shift, and work with the client's job site supervisors to direct the GJW workforce. While GJW maintains that the position is not new, the records shows that there are some variations in the responsibilities of the formalized team leaders, and the informal team leaders. The record also shows that six of GJW's seven other work sites do not yet have a formal lead worker system as memorialized in the MLSA. Therefore, the supervisory structure for GJW employees at ACECO sites varies from the supervisory structure for GJW employees at other client sites.

Additionally, GJW pays its employees working at ACECO sites based on the negotiated contract rates with ACECO. As such, the wages GJW employees receive while on ACECO sites may vary from what they are paid for working on other GJW client sites, even while performing the same type of work. These variations in supervisory structure and potential wage for similar work cut against the argument of an overwhelming community of interest demanding inclusion in the readily identifiable unit. Further, there is insufficient evidence to demonstrate an overwhelming community of interest among all GJW employees that necessitates expanding the unit that I find to be appropriate. As discussed above, it is not necessary for a unit to be the most appropriate unit, it must simply be an appropriate unit.

## IV. CONCLUSIONS AND FINDINGS

Based on the entire record in this matter, and in accordance with the discussion above, I conclude and find as follows:

1. The hearing officer's rulings made at the hearing are free from prejudicial error and are hereby affirmed.

2. Green JobWorks, LLC has been a limited liability company with an office and place of business in Baltimore, Maryland, and has been engaged in business as a temporary staffing agency engaged in the business of demolition and environmental remediation, including asbestos remediation. In conducting its operations during the 12-month period ending June 30, 2015, Green JobWorks, LLC performed services valued in excess of $50,000 in states other than the State of Maryland.

3. ACECO, LLC has been a limited liability company with an office and place of business in Silver Spring, Maryland and has been engaged in the business of providing demolition, environmental remediation and renovation services to private and governmental entities in Maryland, Washington, D.C. and Virginia. In conducting its operations during the 12-month period ending June 30, 2015, ACECO, LLC performed services valued in excess of $50,000 in states other than the State of Maryland.

4. Green JobWorks, LLC and ACECO, LLC are each an employer as defined in Section 2(2) of the Act and are each engaged in commerce within the meaning of Sections 2(6) and (7) of the Act, and it will effectuate the purposes of the Act to assert jurisdiction in this case.

5. Petitioner is a labor organization as defined in Section 2(5) of the Act.

6. A question affecting commerce exists concerning the representation of certain employees of the Employer within the meaning of Section 9(c)(1) and Section 2(6) and (7) of the Act.

7. I find the following employees of Green JobWorks constitute a unit appropriate for the

purpose of collective-bargaining within the meaning of Section 9(b) of the Act:

> All full-time and regular part-time laborers, including demolition and asbestos removal workers, and lead employees employed by Green JobWorks, LLC, and assigned to ACECO, LLC work sites, but excluding office clericals, professionals, confidential employees, managerial employees, guards, and supervisors as defined by the Act.

## V. DIRECTION OF ELECTION

The National Labor Relations Board will conduct a secret ballot election among the employees in the unit found appropriate above. The employees will vote whether or not they wish to be represented for purposes of collective bargaining by the Construction and Master Laborers' Local Union 11, affiliated with Laborers' International Union of North America.

### A. Election Details

I have determined that a mail ballot election will be held. Mail balloting may be used in certain circumstances, such as where the eligible voters are scattered because of their duties or work schedules. In such situations, I may conduct an election by mail ballot, taking into consideration the desires of the parties, the ability of voters to understand mail ballots, and the efficient use of personnel. *San Diego Gas & Electric*, 325 NLRB 1143 (1998). GJW employees are scattered over numerous worksites, and a mail-ballot election is most likely to maximize eligible voter participation in this case.

The election will be conducted by mail. The mail ballots will be mailed to employees employed in the appropriate collective-bargaining unit from the office of the National Labor Relations Board, Region 05, on **November 3, 2015**.

If any eligible voter does not receive a mail ballot or otherwise requires a duplicate mail ballot kit, he or she should contact the Region 05 office at 410-962-2219 by no later than 4:45 p.m. on **November 10, 2015** in order to arrange for another mail ballot kit to be sent to that employee. Voters must return their mail ballots so that they will be received in the National Labor Relations Board, Region 05 office by close of business on **November 23, 2015**.

The mail ballots will be counted at the Region 05 office located at Bank of America Center, Tower II, 100 S. Charles Street, Suite 600, Baltimore, MD 21201 at **2:00 p.m**. on **November 24, 2015.**

### B. Voting Eligibility

Eligible to vote are those in the unit who were employed during the payroll period ending who were employed during the payroll period ending immediately before the date of this Decision, including employees who did not work during that period because they were ill, on vacation, or temporarily laid off.

Employees engaged in an economic strike, who have retained their status as strikers and who have not been permanently replaced, are also eligible to vote. In addition, in an economic strike that commenced less than 12 months before the election date, employees engaged in such strike who have retained their status as strikers but who have been permanently replaced, as well as their replacements, are eligible to vote. Unit employees in the military services of the United States may vote if they appear in person at the polls.

Also eligible to vote are those GJW employees who have been employed for a total of 30 working days or more at an ACECO site within the period of 12 months immediately preceding the eligibility date for the election, or who have some employment in that period and have been employed by GJW for 45 working days or more at an ACECO site within the 24 months immediately preceding the eligibility date for the election, and who have not been terminated for cause or quit voluntarily prior to the completion of the last job for which they were employed.

Ineligible to vote are (1) employees who have quit or been discharged for cause since the designated payroll period; (2) striking employees who have been discharged for cause since the strike began and who have not been rehired or reinstated before the election date; and (3) employees who are engaged in an economic strike that began more than 12 months before the election date and who have been permanently replaced.

**C. Voter List**

As required by Section 102.67(l) of the Board's Rules and Regulations, the Employer must provide the Regional Director and parties named in this decision a list of the full names, work locations, shifts, job classifications, and contact information (including home addresses, available personal email addresses, and available home and personal cell telephone numbers) of all eligible voters.

To be timely filed and served, the list must be *received* by the Regional Director and the parties by **TWO business days after the date of issuance**. The list must be accompanied by a certificate of service showing service on all parties. **The Region will no longer serve the voter list.**

Unless the Employer certifies that it does not possess the capacity to produce the list in the required form, the list must be provided in a table in a Microsoft Word file (.doc or docx) or a file that is compatible with Microsoft Word (.doc or docx). The first column of the list must begin with each employee's last name and the list must be alphabetized (overall or by department) by last name. Because the list will be used during the election, the font size of the list must be the equivalent of Times New Roman 10 or larger. That font does not need to be used but the font must be that size or larger. A sample, optional form for the list is provided on the NLRB website at www.nlrb.gov/what-we-do/conduct-elections/representation-case-rules-effective-April-14-2015.

When feasible, the list shall be filed electronically with the Region and served electronically on the other parties name in this decision. The list may be electronically filed with the Region by using the E-filing system on the Agency's website at www.nlrb.gov. Once the website is accessed, click on **E-File Documents**, enter the NLRB Case Number, and follow the detailed instructions.

Failure to comply with the above requirements will be grounds for setting aside the election whenever proper and timely objections are filed. However, the Employer may not object to the failure to file or serve the list within the specified time or in the proper format if it is responsible for the failure.

No party shall use the voter list for purposes other than the representation proceeding, Board proceedings arising from it, and related matters.

### D. Posting of Notices of Election

Pursuant to Section 102.67(k) of the Board's Rules, the Employer must post copies of the Notice of Election accompanying this Decision in conspicuous places, including all places where notices to employees in the unit found appropriate are customarily posted. The Notice must be posted so all pages of the Notice are simultaneously visible. In addition, if the Employer customarily communicates electronically with some or all of the employees in the unit found appropriate, the Employer must also distribute the Notice of Election electronically to those employees. The Employer must post copies of the Notice at least 3 full working days prior to 12:01 a.m. of the day of the election and copies must remain posted until the end of the election. For purposes of posting, working day means an entire 24-hour period excluding Saturdays, Sundays, and holidays. However, a party shall be estopped from objecting to the nonposting of notices if it is responsible for the nonposting, and likewise shall be estopped from objecting to the nondistribution of notices if it is responsible for the nondistribution.

Failure to follow the posting requirements set forth above will be grounds for setting aside the election if proper and timely objections are filed.

## RIGHT TO REQUEST REVIEW

Pursuant to Section 102.67 of the Board's Rules and Regulations, a request for review may be filed with the Board at any time following the issuance of this Decision until 14 days after a final disposition of the proceeding by the Regional Director. Accordingly, a party is not precluded from filing a request for review of this decision after the election on the grounds that it did not file a request for review of this Decision prior to the election. The request for review must conform to the requirements of Section 102.67 of the Board's Rules and Regulations.

A request for review may be E-Filed through the Agency's website but may not be filed by facsimile. To E-File the request for review, go to www.nlrb.gov, select E-File Documents, enter the NLRB Case Number, and follow the detailed instructions. If not E-Filed, the request for review should be addressed to the Executive Secretary, National Labor Relations Board, 1015 Half Street SE, Washington, DC 20570-0001. A party filing a request for review must serve a copy of the request on the other parties and file a copy with the Regional Director. A certificate of service must be filed with the Board together with the request for review.

Neither the filing of a request for review nor the Board's granting a request for review will stay the election in this matter unless specifically ordered by the Board.

(SEAL)

Dated: October 21, 2015 /s/ Charles L. Posner

Charles L. Posner, Regional Director
National Labor Relations Board, Region 5
Bank of America Center -Tower II
100 South Charles Street, Suite 600
Baltimore, Maryland 21201

# TAB 2

DATE: April 28, 2015

TO: Peter Sung Ohr, Regional Director
Region 13

FROM: Barry J. Kearney, Associate General Counsel
Division of Advice

SUBJECT: Nutritionality, Inc. d/b/a Freshii 177-1650-0100
Cases 13-CA-134294, 13-CA-138293, and
13-CA-142297

The Region submitted this case for advice as to whether Nutritionality, Inc., as a franchisee, is a joint employer with Freshii Development, LLC and/or Freshii's franchise development agent for the Chicagoland area. We conclude that neither Freshii nor its Chicagoland development agent are joint employers with Nutritionality under current Board law or the General Counsel's proposed standard.

## FACTS

Freshii Development, LLC ("Freshii") is a fast-casual restaurant chain that focuses on providing fresh and nutritious meal choices. There are over 100 Freshii stores, which are operated as franchises in over a dozen countries. Freshii contracts with "development agents" in different geographic locations to cultivate new franchises and help ensure mandatory brand standards for existing franchises.

Nutritionality, Inc. ("Nutritionality") operates a single Freshii store in Chicago, Illinois. Nutritionality signed a franchise agreement around November 2010, and the store opened around May 2011. The franchise generally employs between five and nine employees. In the summer of 2014, Nutritionality terminated one employee and disciplined and terminated another employee for attempting to unionize the workforce. The Region found merit to unfair labor practice allegations regarding the terminations and discipline but requested advice as to whether Nutritionality is a joint employer with Freshii and/or with the Chicagoland development agent.

### The Freshii Franchise Agreement

The Freshii franchise agreement grants a franchisee the right "to own and operate a Freshii Restaurant using [Freshii's] business system, business formats, methods, procedures, designs, layouts, trade dress, standards, specifications and [trademarks], all of which [Freshii] may improve, further develop and otherwise modify periodically." Under the agreement, franchisees pay an initial franchisee fee and ongoing royalties (six percent of gross monthly sales) to Freshii.

The agreement also states that Freshii may terminate the franchise agreement for twenty different reasons, including if the franchisee interferes with Freshii's right to inspect the restaurant, if the franchisee fails to pay Freshii, or if the franchisee "fails to comply with any other provision of this Agreement or the Operations Manual, or any mandatory System Standard, and does not correct the failure within thirty (30) days after [Freshii] delivers written notice of the failure" to the franchisee.

**Operations Manual, Tools, and Oversight of the Franchisee**

Freshii provides its franchisees with an Operations Manual that "contains mandatory and suggested specifications, standards, operating procedures and rules that Freshii periodically prescribes for operating a Freshii Restaurant," i.e., "System Standards." The franchise agreement states that System Standards may regulate any aspect of the operation and maintenance of the restaurant, including, inter alia, sales, marketing, advertising and promotion materials; staffing levels, appearance, service, and job functions for restaurant employees; pricing requirements; ingredients and methods of preparing foods; standards for training managers; use of trademarks; days and hours of operation; payment systems; and any other aspects of operating and maintaining the restaurant that Freshii determines to be useful to preserve or enhance the efficient operation, image, or goodwill of Freshii.[1] On the other hand, the franchise agreement specifies that System Standards do not include "any personnel policies or procedures," which Freshii may make available for franchisees' optional use, and that the franchisee alone will "determine to what extent, if any, these policies and procedures might apply" to its restaurant operations. The franchise agreement also states that Freshii "neither dictates nor controls labor or employment matters for franchisees and their employees…."

The Operations Manual also contains guidance on how to conform to the System Standards. In this regard, sections of the manual address menu item preparation, including which employees are in charge of taking an order, preparing the order, and providing samples to potential customers; food safety regulations; instructions on how to use and clean equipment; and guest service basics.

The Operations Manual also contains guidance on human resources matters, such as hiring and scheduling employees. For example, the manual includes a sample

[1] There is evidence that Freshii does not actively enforce the non-food-related requirements. For example, after Freshii updated its logo and tagline, it did not require any franchises to update their materials. The Chicagoland development agent states that he has not known Freshii to ever force franchisees to do anything.

hiring advertisement and sample interview questions to ask potential hires. Additionally, the manual explains how to calculate "labor cost percentage" based on the actual labor used and how to project labor calculations to schedule staff in advance. Freshii does not require franchisees to follow its guidance on these topics, which, as mentioned above, are outside the scope of the mandatory System Standards.

Freshii also provides franchisees with a sample employee handbook that contains personnel policies but does not require franchisees to use the handbook and policies. Although Nutritionality used the handbook provided by Freshii, other franchisees, specifically the stores owned by the Chicagoland development agent, used a different handbook that contained different employment policies.

Franchisees also must install and use equipment approved by Freshii, including computer hardware and software. While Freshii requires all franchises to use the same point-of-sale system, new franchises use one system while older franchisees use another without having to upgrade. Additionally, one Chicago franchise uses a completely different system that the franchisee uses in his other franchised Sbarro restaurants. Other than passively monitoring sales and costs, there is no evidence that Freshii is actively involved in the point-of-sale systems or any scheduling software that may or may not be incorporated, and there is no evidence that Freshii has any input into scheduling algorithms or methods used in the software.

**Development Agents and Training**

Freshii contracts with individuals throughout the country to be development agents. Development agents are responsible for cultivating stores in particular geographic locations, including helping potential and future franchisees find appropriate real estate for potential restaurants, architects for the restaurant design, contractors for building the restaurants, and third-party product lines for snacks.[2] Development agents receive a percentage of the franchise fee and royalties that a franchisee pays to Freshii. There is no contractual relationship between the development agents and the franchisee stores that they oversee. The Chicagoland development agent states that he is not involved in the hiring, firing, or scheduling of employees in any of the franchise stores in his area, other than those he owns and operates.

Additionally, a development agent's store is used to train new franchisees within the geographic area. All franchisee owners and managers are required to undergo a four-week training period before a new franchise can open. The first three weeks cover the menu, recipes, food preparation and ordering, along with showing owners

[2] Development agents also operate their own Freshii franchises.

how to schedule and use the point-of-sale system. During the last week of training, the franchisee owner is the manager-on-duty for the development agent's store. When a new franchise is set to open, the development agent will train the entire staff for three days prior to the opening, and will stay for the next five days to ensure that the store is organized and running smoothly. During both owner and employee trainings, development agents use digital documents provided by Freshii that outline the duties of various positions and how to make Freshii products. According to the Chicagoland development agent, other than the initial store opening training, franchisees are responsible for training their staffs without the help of development agents.

After a new store is operational, development agents, with the help of their employees, called area directors, perform monthly store evaluations for all franchisees. According to the Chicagoland development agent, the purpose of these evaluations is to ensure that everyone is wearing Freshii uniforms, the food is being made correctly, the store is clean, and proper promotional material is on the wall. To the development agent's knowledge, there are no employment-related standards. The development agent sends evaluation reports to Freshii only if it shows significant deviation from mandatory brand standards. For example, the Chicagoland development agent recommended to Freshii that action be taken against Nutritionality for failing to meet brand standards. However, there is no evidence that Freshii attempted to end Nutritionality's franchise agreement or otherwise take action against Nutritionality, other than send a few letters.

In addition to the monthly evaluations, development agents visit each franchisee store once or twice a month. The Chicagoland development agent states that he recently visited one franchise and noticed that the store was dirty and that there were four employees working during a slow time. The agent later emailed the franchisee about his concerns (no uniforms, store uncleanliness, too many employees working, etc.), and the franchisee replied by thanking him. Franchisees are not required to take any action based on such findings, and to the Chicagoland development agent's knowledge, no franchisee has ever taken action against an employee because of his feedback.

**Franchise Labor Relations**

Individual franchisees are exclusively responsible for hiring their staffs. Although the Freshii website allows potential applicants to apply to stores online, there is no evidence that Freshii screens or analyzes the applications in any way. Nutritionality's owner testified that he typically either hires employees through word of mouth or through Craigslist advertisements.

Additionally, individual franchisees are exclusively responsible for setting employee wages and benefits. There is no evidence that franchisees need to consult with Freshii or a development agent in order to grant wage increases, decreases, or changes to benefits. The owner of Nutritionality has both increased and decreased specific employees' wages unilaterally without seeking approval from Freshii.

Individual franchisees are also exclusively responsible for disciplining and discharging their employees, and Nutritionality has disciplined and discharged employees without consulting Freshii. While the Operations Manual includes sections regarding coaching and counseling policies, as well as employee conduct that may warrant discharge, there is no evidence that franchisees must follow these sections. To the contrary, as stated above, the franchise agreement explicitly states that it is up to the franchisee to decide to what extent, if any, it would follow Freshii's personnel policies. Additionally, as mentioned above, during store reviews and visits, a development agent may raise an issue about an employee, but there is no evidence that any employee has ever been disciplined or discharged because of a development agent's comments.

**Freshii's involvement with Nutritionality regarding the alleged unfair labor practices**

There is no evidence that Freshii or its development agents are involved in Nutritionality's labor relations or provided guidance about how to deal with a possible union organizing campaign. In one instance, Nutritionality's owner told the Chicagoland development agent that if employees were more than five minutes late, he would require them to clock in and work but would not begin paying them until the next half hour. The development agent told him that if employees clock in, the franchisee has to pay them for every minute. Around the same time, Nutritionality's owner told the development agent that employees had presented Nutritionality with a letter asking it to recognize a union as their collective-bargaining representative. The development agent did not instruct him how to respond; instead, he asked Freshii about the incident and Freshii responded that it had not heard anything about unions organizing employees. Neither Freshii nor the development agent followed up with Nutritionality about the organizing effort.

## ACTION

We conclude that Nutritionality and Freshii are not joint employers under the Board's current standard or under the traditional joint employer standard being urged by the General Counsel because there is no evidence that Nutritionality shares or codetermines with Freshii matters governing the essential terms and conditions of employment of Nutritionality's employees.[3]

[3] The instant ULP charges allege that Nutritionality is a joint employer with the Chicagoland development agent, who operates an independent company that is

## A. Freshii and Nutritionality are not Joint Employers under the Board's Current Standard.

The Board will find that two separate entities are joint employers of a single workforce if they "share or codetermine those matters governing the essential terms and conditions of employment."[4] To establish such status, a business entity must meaningfully affect matters relating to the employment relationship "such as hiring, firing, discipline, supervision, and direction."[5] As recently noted by the Board in *CNN*, the Board and the courts have also considered other factors in making a joint employer determination, including an employer's involvement in decisions relating to wages and compensation, the number of job vacancies to be filled, work hours, the assignment of work and equipment, employment tenure, and an employer's involvement in the collective bargaining process.[6]

Here, applying the current standard, the evidence does not establish that Freshii meaningfully affects any matters pertaining to the employment relationship between Nutritionality and its employees. Freshii has played no role in Nutritionality's decisions regarding hiring, firing, disciplining or supervising employees. While potential applicants are able to submit resumes through Freshii's website for employment at franchise locations, there is no evidence that Freshii screens the resumes or does anything other than forward them on to individual franchises. Further, there is no evidence that anyone other than Nutritionality is responsible for determining wages, raises, or benefits of its employees. Indeed, Nutritionality's owner regularly increased and decreased employees' wages without Freshii's involvement. And Nutritionality uses a different employee handbook with different

involved in numerous business enterprises, including several Freshii franchises and other restaurant franchises. In his role as Freshii's Chicagoland development agent, he helps Freshii prepare new franchises to begin operations and monitors brand standards at existing franchises. Aside from these activities, which fall strictly within the development agent's agreement with Freshii, the investigation clearly revealed that the development agent was not a joint employer with Nutritionality. Thus, the following analysis only addresses whether Freshii and Nutritionality are joint employers.

[4] *CNN America, Inc.*, 361 NLRB No. 47, slip op. at 3 (Sept. 15, 2014) (citing *TLI, Inc.*, 271 NLRB 798, 798 (1984), citing *NLRB v. Browning-Ferris Industries of Pennsylvania*, 691 F.2d 1117, 1123-24 (3d Cir. 1982)).

[5] *Id.* (citing *Laerco Transportation*, 269 NLRB 324, 325 (1984)).

[6] *CNN*, 361 NLRB No. 47, slip op. at 3 n.7 & 7.

personnel policies than the Chicagoland development agent uses for his Freshii franchises. All of this evidence is consistent with the clear language of the franchise agreement, which gives the franchisee the power to determine whether to use Freshii's personnel policies or procedures and states that Freshii "neither dictates nor controls labor or employment matters for franchisees and their employees…."

Additionally, Freshii is not involved in Nutritionality's scheduling and setting work hours of its employees. While Freshii provides guidance on how to calculate labor costs to ensure that restaurants are not over- or understaffed, there is no evidence that Freshii, directly or through scheduling software or the development agent, ever instructed Nutritionality to reduce an employee's hours or send an employee home because labor costs at a particular time were too high.[7] Nor is there evidence that Freshii has any input into scheduling algorithms or methods used in any scheduling software. Further, since Freshii does not enforce its requirement that every franchise use the same system, there are at least three different point-of-sale systems being using by Chicago-area franchises, all of which may contain their own scheduling software.

Also, the required trainings that owners and managers must attend prior to opening a franchise deal primarily with operating a restaurant. While the trainings may also offer recommendations and guidance similar to what is outlined in Freshii's Operations Manual and handbook regarding employee personnel policies, such as hiring, scheduling, and disciplinary practices, Freshii does not require franchisees to follow those recommendations. Additionally, after the initial training, Freshii and its development agents have no involvement in any future trainings, highlighting a lack of impact on franchise employees' terms and conditions of employment.

At most, Freshii's control over Nutritionality's operations are limited to ensuring a standardized product and customer experience, factors that clearly do not evince sharing or codetermining matters governing essential terms and conditions of employment. This case is therefore similar to *Love's Barbeque Restaurant*, where the ALJ, in a decision adopted by the Board, found that materials prescribing the recipes for food preparation and the sizes and portions of the menu items offered ultimately did not tend to establish joint employer status, as they "relate[d] to the image, the historical image of the [franchisor's] chain," as opposed to labor relations.[8] And, as in

[7] Indeed, the Chicagoland development agent states that he communicated his concerns about staffing levels at a different store to that store's franchisee but that the franchisee's only response was to thank him.

[8] *Love's Barbeque Restaurant No. 62*, 245 NLRB 78, 120 (1978), enforced in rel. part, 640 F.2d 1094 (9th Cir. 1981).

*Love's Barbeque*, Freshii's requirements regarding the "design, decoration and décor" of its franchisees' restaurants is hardly a matter that affects labor relations.[9] Similarly, other than the recipes and décor elements, there is evidence that other parts of the Operations Manual are recommendations rather than mandatory requirements.[10] Lastly, Freshii's requirements regarding uniforms, initial training of employees, and store hours, without more, are not a basis for finding a joint employer relationship.[11] Thus, Freshii's requirements regarding food preparation, recipes, menu, uniforms, décor, store hours, and initial employee training prior to a franchise opening are not evidence of control over Nutritionality's labor relations but rather establish Freshii's legitimate interest in protecting the quality of its product and brand.

Similarly, the monthly reviews by development agents are limited to inspecting franchisees' adherence to Freshii's mandatory brand standards described above, primarily the menu and food products, and are not used to examine any employment-related policies. Thus, franchisees are not reviewed on their hiring, discipline, scheduling, or wage policies. Freshii only obtains a report of the review if a development agent finds a significant deviation from the brand standards. And even after Freshii receives the reports, Freshii is under no obligation to follow a development agent's recommendations. There is no evidence that a review ever affected an employee's terms and conditions of employment either through discipline or discharge. In addition to the reviews, development agents try to visit each franchise once or twice a month and often email notes and suggestions to owners afterwards. But franchisees, including Nutritionality, are not required to make any changes that a development agent suggests after store visits.

Freshii additionally does not meaningfully affect Nutritionality's employees' terms and conditions through its contractual right to terminate the franchise agreement. The record evidence demonstrates that a franchise agreement could be

[9] *Id.* at 119.

[10] *Id.* at 120 (finding that descriptions of employee duties in operating manual were recommendations and not required to be followed).

[11] *See e.g., S. G. Tilden, Inc.*, 172 NLRB 752, 753 (1968) (requirement that franchisees' employees wear prescribed uniforms "amounts to nothing more than an implementation of [the franchisor's] advertising policy"; "offer to train prospective employees" was "not the exercise of any authority over [franchisees'] hiring policies"; and requirement that franchisees' shops be open certain hours and days of the week "in no way prescribes the hours that a particular employee must work" and was designed to "eliminate unfair competition among franchisees").

terminated for failure to maintain brand standards. Indeed, the Chicagoland development agent recommended to Freshii that Nutritionality's franchise agreement be terminated because it continually failed to meet brand standards; the recommendation was not based on labor relations, working conditions, or employee scheduling or compensation. However, Freshii has not followed the development agent's recommendation and has not attempted to terminate Nutritionality's franchise. There is no evidence that any franchise has been terminated for non-brand related reasons.

Lastly, the events that precipitated the instant ULP charges stemming from Nutritionality's employees' organizing efforts further demonstrate Freshii's lack of involvement in Nutritionality's dealings with its employees. Even after Nutritionality's owner asked Freshii, via the development agent, for advice on the situation, Freshii remained silent and did not interfere or instruct Nutritionality's owner as to how to respond to the employees' organizing efforts.[12]

**B. Freshii and Nutritionality are not Joint Employers under the General Counsel's Proposed Standard.**

Recently, the General Counsel has urged the Board to return to its traditional joint employer standard.[13] Under that standard, the Board finds joint employer status where, under the totality of the circumstances, including the way the separate entities have structured their commercial relationship, the putative joint employer wields sufficient influence over the working conditions of the other entity's employees such that meaningful bargaining could not occur in its absence. This approach makes no distinction between direct, indirect and potential control over working conditions and results in a joint employer finding where "industrial realities" make an entity essential for meaningful bargaining.

Applying the General Counsel's proposed standard, we conclude that Freshii and Nutritionality are not joint employers of Nutritionality's employees. As discussed above, Freshii does not significantly influence the working conditions of Nutritionality's employees. For example, it has no involvement in hiring, firing, discipline, supervision, or setting wages. Thus, because Freshii does not directly or indirectly control or otherwise restrict the employees' core terms and conditions of employment, meaningful collective bargaining between Nutritionality and any

[12] *See e.g., Love's Barbeque*, 245 NLRB at 120 (ALJ, in decision adopted by the Board, found it significant that franchisor had not become involved in how the franchisee should handle its labor dispute with the union).

[13] *See* Amicus Brief of the General Counsel at 2, 16-17, *Browning-Ferris Industries of California d/b/a BFI Newby Island Recyclery*, Case 32-RC-109684 (June 26, 2014).

potential collective-bargaining representative of the employees could occur in Freshii's absence.

Based on the above, we conclude that Freshii and Nutritionality are not joint employers, under both the Board's current joint employer standard as espoused in *CNN*, and the standard recently proposed by the General Counsel.

/s/
B.J.K.

**Qualified Retirement Plans and the Contingent Workforce**

**By: Sherrie Boutwell, Boutwell Fay LLP**

Qualified retirement plans are subject to complex statutory and regulatory requirements under both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 ("ERISA"). The rise of the contingent workforce raises a number of issues under such plans. These include, but are not necessarily limited to, the following:

1. Qualified retirement plans are required to cover a minimum number of eligible employees in a non-discriminatory manner. In order to meet these requirements, the employer must properly determine whether an individual providing services to an employer is, or is not, an employee of that employer.

2. Because qualified retirement plans must be designed and operated for the "exclusive benefit" of sponsoring employers, it is also critical that persons who are *not* employees of an employer sponsoring a qualified plan *not* be permitted to participate in the plan unless the plan is drafted and operated as a "multiple employer" plan. Note – the law concerning what are commonly referred to as "Open MEPS" is still unsettled with the Department of Labor having taken the position that employers should have some nexus (other than wanting to reduce plan administrative costs) in order to jointly participate in a MEP and Congress considering legislation to allow them.

3. Employers using "contingent workers" must design their plans to take into account the unique nature of their workforce. Here are some suggested approaches:

    a. Include a requirement that an employee complete 1000 hours of service (rather than using an elapsed time method of counting service, which ignores hours).

    b. Include a requirement that an employee be employed on an entry date (only 2 per year are required) in order to enter the plan, rather than allowing immediate participation.

    c. Take care with using "auto enrollment" and "auto escalation" clauses in plans.

    d. Take into account the strict rules that apply to employees who are terminated and then rehired within short periods.

    e. Include exclusionary language in the plan documents for:

        i. "Leased" employees
        ii. Independent contractors

iii. Re-classified employees
iv. Shared employees
v. Employees of staffing agencies/professional employer organizations
vi. Employees of acquired companies

## Checklist for Misclassified Employee Issues In Qualified Retirement Plans

If an employee is re-classified (or if you believe you may have misclassified one or more employees), you will want to review the following issues with your plan advisors:

1. **Plan language/employee rights**. Individual participants have standing to enforce the terms of benefit plans subject to ERISA (and could be part of a class action as well). For each year that is affected, review the following documents to determine if employees have been denied any rights under the applicable plan documents/representations:

    a. Plan documents (adoption agreements, base plan documents)
    b. Plan amendments
    c. Summary plan descriptions & summaries of material modifications
    d. Other plan communications and disclosures to employees and participants (e.g., employee handbooks, enrollment materials/screens)
    e. Board resolutions
    f. Internal administrative procedures
    g. Internal communications
    h. Communications with outside service providers (including counsel, attorney client privilege may or may not apply in this context)

    Depending on the plan provisions/evidence, you may either need to treat the newly reclassified employees as plan participants or seek either IRS or court approval of a retroactive amendment to exclude them (note – the circumstances supporting a retroactive amendment are rare) – see attached article “The Billion Dollar Typo.” Some of these problems can be prevented by adding proper exclusionary language to the plan documents (see sample below).

2. **Service Crediting/Other issues**. For each employee that was misclassified, determine proper service credit for each plan, back to the date that they first should have been treated as an employee. Service credit can affect eligibility, benefit accrual and vesting in retirement plans. You may need to use plan specified equivalencies or other reasonable methods of estimating/extrapolation in order to determine proper service credit.

3. **Required Coverage/Non-discrimination Tests.** You may need to provide an updated corrected employee census to your plan service providers and have them re-run the following required coverage/non-discrimination tests.

    a. Coverage Tests (Code Section 410(b))
    b. Non-Discrimination Tests (Code Section 401(a)(4))
    c. Minimum Participation Tests (Code Section 401(a)(26))
    d. ADP/ACP Tests (Code Section 401(k) and 401(m))
    e. Top Heavy Tests (Code Section 416)
    f. Definition of Compensation (Code Section 417)

    If a plan fails to meet a requirement or has improperly excluded persons who are now considered employees, consult with your advisors – the plan may need to be voluntarily corrected in order to maintain its tax qualified status.

    Note - if there was a prior correction of a plan qualification defect, you may need to review whether the correction previously made is still adequate after individuals are re-classified as employees.

4. **Dollar/Other Contribution Limits.** Benefits under qualified retirement plans are subject to strict dollar or annual benefit limits, some of which apply on an employer by employer basis and others that apply on an individual basis. These will need to be reviewed as to any reclassified employees.

5. **Risk Mitigation**. Review applicable insurance policies for coverage and notice requirements (errors & omissions, fiduciary insurance, etc.); consider potential claims against 3rd parties.

    **Sample Exclusionary provision:**

    The term "Eligible Employee" shall not include any individual that is not treated on the payroll records of the Employer as a common law employee of the Employer, even if the individual is later reclassified as a common law employee of the Employer by a court or administrative agency as a common law employee of the Employer. Notwithstanding the foregoing, if, as a result of a reclassification of individuals as common law employees, the Plan fails to meet the requirement that the Plan cover a nondiscriminatory classification of employees under Section 410(b) of the Internal Revenue Code, such individuals may be included in the Plan to the extent necessary to satisfy Code Section 410(b), as provided in Section ___ of the Plan [cite to coverage failsafe provision].

    **Referenced Materials Attached:**

    1. **IRS Revenue Ruling 87-41:** describes factors used to determine employee vs non-employee status under "common law".

2. **Vizcaino v. Microsoft Corp.** (97 F.3d 1187): 9th Circuit case holding that reclassified employees are eligible for the certain employee benefit plans, in spite of having signed waivers of those benefits.
3. **IRS Revenue Procedure 2002-21:** guidance for correcting plans of professional employer organizations ("PEOs") that violate the Code's qualification requirements.
4. **DOL Advisory Opinion 2012-04A:** guidance regarding open "MEP" plans.
5. **"The Billion Dollar Typo":** by Sherrie Boutwell and Deborah Fabricant (December 2009).
6. ***Euchner-USA, Inc. v. Hartford Casualty Insurance Co.*** (2d Cir. 2014) 754 F.3d 136.

| **Comparison of IRS and DOL Tests for Determining Who is an Employee** | |
|---|---|
| **DOL** | **IRS** |
| **Focus – Is the worker "economically dependent" on the employer** | **Focus – Who is in control?** |
| Is the work an integral part of employer's business? | Are the services integrated with the employer's business? |
| Do the worker's managerial skills affect their opportunity for profit or loss? | Can the worker realize a profit or loss from their work? |
| What is the relative investment by the employer and the employee? | Does employee pay their own travel/business expenses? Buy tools and equipment? |
| Does the employee have any special skills relative to an independent business? | Employer provides and requires training of worker? |
| How permanent is the relationship? | Continuing relationship? |
| How much control does the employer have over the worker? | Employer gives instructions about how, when and where the work is performed; sets work hours, person works full or part time? Work is done on employer's premises; sequencing of tasks: regular written reports; payment by hour/week/month? |
| | Services are rendered personally (worker cannot hire own workers) |
| | Employer hires assistants for the service provider |
| | Worker is free to work for others or to the general public |
| | Employer has unilateral right to discharge or terminate |

# 20 Common Law Factors

## Rev. Rul. 87-41, 1987-1 CB 296

### ISSUE

In the situations described below, are the individuals employees under the common law rules for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (chapters 21, 23, and 24 respectively, subtitle C, Internal Revenue Code)? These situations illustrate the application of section 530(d) of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. 119 (the 1978 Act), which was added by section 1706(a) of the Tax Reform Act of 1986, 1986- 3 (Vol. 1) C.B. 698 (the 1986 Act) (generally effective for services performed and remuneration paid after December 31, 1986).

### FACTS

In each factual situation, an individual worker (Individual), pursuant to an arrangement between one person (Firm) and another person (Client), provides services for the Client as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

Situation 1

The Firm is engaged in the business of providing temporary technical services to its clients. The Firm maintains a roster of workers who are available to provide technical services to prospective clients. The Firm does not train the workers but determines the services that the workers are qualified to perform based on information submitted by the workers.

The Firm has entered into a contract with the Client. The contract states that the Firm is to provide the Client with workers to perform computer programming services meeting specified qualifications for a particular project. The Individual, a computer programmer, enters into a contract with the Firm to perform services as a computer programmer for the Client's project, which is expected to last less than one year. The Individual is one of several programmers provided by the Firm to the Client. The Individual has not been an employee of or performed services for the Client (or any predecessor or affiliated corporation of the Client) at any time preceding the time at which the Individual begins performing services for the Client. Also, the Individual has not been an employee of or performed services for or on behalf of the Firm at any time preceding the time at which the Individual begins performing services for the Client. The Individual's contract with the Firm states that the Individual is an independent contractor with respect to services performed on behalf of the Firm for the Client.

The Individual and the other programmers perform the services under the Firm's contract with the Client. During the time the Individual is performing services for the Client, even though the Individual retains the right to perform services for other persons, substantially all of the Individual's working time is devoted to performing services for the Client. A significant portion of the services are performed on the Client's premises. The Individual reports to the Firm by accounting for time worked and describing the progress of the work. The Firm pays the Individual and regularly charges the Client for the services performed by the Individual. The Firm generally does not pay individuals who perform services for the Client unless the Firm provided such individuals to the Client.

The work of the Individual and other programmers is regularly reviewed by the Firm. The review is based primarily on reports by the Client about the performance of these workers. Under the contract between the Individual and the Firm, the Firm may terminate its relationship with the Individual if the review shows that he or she is failing to perform the services contracted for by the Client. Also, the Firm will replace the Individual with another worker if the Individual's services are unacceptable to the Client. In such a case, however, the Individual will nevertheless receive his or her hourly pay for the work completed.

Finally, under the contract between the Individual and the Firm, the Individual is prohibited from performing services directly for the Client and, under the contract between the

Firm and the Client, the Client is prohibited from receiving services from the Individual for a period of three months following the termination of services by the Individual for the Client on behalf of the Firm.

**Situation 2**

The Firm is a technical services firm that supplies clients with technical personnel. The Client requires the services of a systems analyst to complete a project and contacts the Firm to obtain such an analyst. The Firm maintains a roster of analysts and refers such an analyst, the Individual, to the Client. The Individual is not restricted by the Client or the Firm from providing services to the general public while performing services for the Client and in fact does perform substantial services for other persons during the period the Individual is working for the Client. Neither the Firm nor the Client has priority on the services of the Individual. The Individual does not report, directly or indirectly, to the Firm after the beginning of the assignment to the Client concerning (1) hours worked by the Individual, (2) progress on the job, or (3) expenses incurred by the Individual in performing services for the Client. No reports (including reports of time worked or progress on the job) made by the Individual to the Client are provided by the Client to the Firm.

If the Individual ceases providing services for the Client prior to completion of the project or if the Individual's work product is otherwise unsatisfactory, the Client may seek damages from the Individual. However, in such circumstances, the Client may not seek damages from the Firm, and the Firm is not required to replace the Individual. The Firm may not terminate the services of the Individual while he or she is performing services for the Client and may not otherwise affect the relationship between the Client and the Individual. Neither the Individual nor the Client is prohibited for any period after termination of the Individual's services on this job from contracting directly with the other. For referring the Individual to the Client, the Firm receives a flat fee that is fixed prior to the Individual's commencement of services for the Client and is unrelated to the number of hours and quality of work performed by the Individual. The Individual is not paid by the Firm either directly or indirectly. No payment made by the Client to the Individual reduces the amount of the fee that the Client is otherwise required to pay the Firm. The Individual is performing services that can be accomplished without the Individual's receiving direction or control as to hours, place of work, sequence, or details of work.

**Situation 3**

The Firm, a company engaged in furnishing client firms with technical personnel, is contacted by the Client, who is in need of the services of a drafter for a particular project, which is expected to last less than one year. The Firm recruits the Individual to perform the drafting services for the Client. The Individual performs substantially all of the services for the Client at the office of the Client, using materials and equipment of the Client. The services are performed under the supervision of employees of the Client. The Individual reports to the Client on a regular basis. The Individual is paid by the Firm based on the number of hours the Individual has worked for the Client, as reported to the Firm by the Client or as reported by the Individual and confirmed by the Client. The Firm has no obligation to pay the Individual if the Firm does not receive payment for the Individual's services from the Client. For recruiting the Individual for the Client, the Firm receives a flat fee that is fixed prior to the Individual's commencement of services for the Client and is unrelated to the number of hours and quality of work performed by the Individual. However, the Firm does receive a reasonable fee for performing the payroll function. The Firm may not direct the work of the Individual and has no responsibility for the work performed by the Individual. The Firm may not terminate the services of the Individual. The Client may terminate the services of the Individual without liability to either the Individual or the Firm. The Individual is permitted to work for another firm while performing services for the Client, but does in fact work for the Client on a substantially full-time basis.

**LAW AND ANALYSIS**

This ruling provides guidance concerning the factors that are used to determine whether an employment relationship exists between the Individual and the Firm for federal employment tax purposes and applies those factors to the given factual situations to determine whether the

Individual is an employee of the Firm for such purposes. The ruling does not reach any conclusions concerning whether an employment relationship for federal employment tax purposes exists between the Individual and the Client in any of the factual situations.

Analysis of the preceding three fact situations requires an examination of the common law rules for determining whether the Individual is an employee with respect to either the Firm or the Client, a determination of whether the Firm or the Client qualifies for employment tax relief under section 530(a) of the 1978 Act, and a determination of whether any such relief is denied the Firm under section 530(d) of the 1978 Act (added by section 1706 of the 1986 Act).

An individual is an employee for federal employment tax purposes if the individual has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship. Guides for determining that status are found in the following three substantially similar sections of the Employment Tax Regulations: sections 31.3121(d)-1(c); 31.3306(i)- 1; and 31.3401(c)-1.

These sections provide that generally the relationship of employer and employee exists when the person or persons for whom the services are performed have the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as to how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so.

Conversely, these sections provide, in part, that individuals (such as physicians, lawyers, dentists, contractors, and subcontractors) who follow an independent trade, business, or profession, in which they offer their services to the public, generally are not employees.

Finally, if the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such a relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like.

As an aid to determining whether an individual is an employee under the common law rules, twenty factors or elements have been identified as indicating whether sufficient control is present to establish an employer- employee relationship. The twenty factors have been developed based on an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. The twenty factors are designed only as guides for determining whether an individual is an employee; special scrutiny is required in applying the twenty factors to assure that formalistic aspects of an arrangement designed to achieve a particular status do not obscure the substance of the arrangement (that is, whether the person or persons for whom the services are performed exercise sufficient control over the individual for the individual to be classified as an employee). The twenty factors are described below:

1. *Instructions.* A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the *right* to require compliance with instructions. See, for example, Rev. Rul. 68-598, 1968-2 C.B. 464, and Rev. Rul. 66- 381, 1966-2 C.B. 449.

2. *Training.* Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner. See Rev. Rul. 70-630, 1970-2 C.B. 229.

3. *Integration.* Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be

subject to a certain amount of control by the owner of the business. See *United States v. Silk,* 331 U.S. 704 (1947), 1947-2 C.B. 167.

4. *Services Rendered Personally.* If the services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results. See Rev. Rul. 55-695, 1955-2 C.B. 410.

5. *Hiring, Supervising, and Paying Assistants.* If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, 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. Compare Rev. Rul. 63-115, 1963-1 C.B. 178, with Rev. Rul. 55-593, 1955-2 C.B. 610.

6. *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. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals. See *United States v. Silk.*

7. *Set Hours of Work.* The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control. See Rev. Rul. 73-591, 1973-2 C.B. 337.

8. *Full Time Required.* If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses. See Rev. Rul. 56- 694, 1956-2 C.B. 694.

9. *Doing Work on Employer's Premises.* 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. Rev. Rul. 56-660, 1956-2 C.B. 693. 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. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer's premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required. See Rev. Rul. 56-694.

10. *Order or Sequence Set.* If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so. See Rev. Rul. 56-694.

11. *Oral or Written 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. See Rev. Rul. 70-309, 1970-1 C.B. 199, and Rev. Rul. 68- 248, 1968-1 C.B. 431.

12. *Payment by Hour, Week, Month.* Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor. See Rev. Rul. 74-389, 1974-2 C.B. 330.

13. *Payment of Business and/or Traveling Expenses.* If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's

business activities. See Rev. Rul. 55-144, 1955-1 C.B. 483.

14. *Furnishing of Tools and Materials.* 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. See Rev. Rul. 71-524, 1971-2 C.B. 346.

15. *Significant Investment.* If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship. See Rev. Rul. 71-524. Special scrutiny is required with respect to certain types of facilities, such as home offices.

16. *Realization of Profit or Loss.* 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, but the worker who cannot is an employee. See Rev. Rul. 70-309. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.

17. *Working for More Than One Firm at a Time.* If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. See Rev. Rul. 70-572, 1970-2 C.B. 221. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.

18. *Making Service Available to General Public.* The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship. See Rev. Rul. 56-660.

19. *Right to Discharge.* 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. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications. Rev. Rul. 75-41, 1975-1 C.B. 323.

20. *Right to Terminate.* If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship. See Rev. Rul. 70-309.

Rev. Rul. 75-41 considers the employment tax status of individuals performing services for a physician's professional service corporation. The corporation is in the business of providing a variety of services to professional people and firms (subscribers), including the services of secretaries, nurses, dental hygienists, and other similarly trained personnel. The individuals who are to perform the services are recruited by the corporation, paid by the corporation, assigned to jobs, and provided with employee benefits by the corporation. Individuals who enter into contracts with the corporation agree they will not contract directly with any subscriber to which they are assigned for at least three months after cessation of their contracts with the corporation. The corporation assigns the individual to the subscriber to work on the subscriber's premises with the subscriber's equipment. Subscribers have the right to require that an individual furnished by the corporation cease providing services to them, and they have the further right to have such individual replaced by the corporation within a reasonable period of time, but the subscribers have no right to affect the contract between the individual and the corporation. The corporation retains the right to discharge the individuals at any time. Rev. Rul. 75-41 concludes that the individuals are employees of the corporation for federal employment tax purposes.

Rev. Rul. 70-309 considers the employment tax status of certain individuals who perform services as oil well pumpers for a corporation under contracts that characterize such individuals as independent contractors. Even though the pumpers perform their services away from the headquarters of the corporation and are not given day-to-day directions and instructions, the ruling concludes that the pumpers are employees of the corporation because the pumpers perform their services pursuant to an arrangement that gives the corporation the right to exercise whatever control is necessary to assure proper performance of the services; the pumpers' services are both necessary and incident to the business conducted by the corporation; and the pumpers are not engaged in an independent enterprise in which they assume the usual business risks, but rather work in the course of the corporation's trade or business. See also Rev. Rul. 70-630, 1970-2 C.B. 229, which considers the employment tax status of salesclerks furnished by an employee service company to a retail store to perform temporary services for the store.

Section 530(a) of the 1978 Act, as amended by section 269(c) of the Tax Equity and Fiscal Responsibility Act of 1982, 1982-2 C.B. 462, 536, provides, for purposes of the employment taxes under subtitle C of the Code, that if a taxpayer did not treat an individual as an employee for any period, then the individual shall be deemed not to be an employee, unless the taxpayer had no reasonable basis for not treating the individual as an employee. For any period after December 31, 1978, this relief applies only if both of the following consistency rules are satisfied: (1) all federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee ("reporting consistency rule"), and (2) the taxpayer (and any predecessor) has not treated any individual holding a substantially similar position as an employee for purposes of the employment taxes for periods beginning after December 31, 1977 ("substantive consistency rule").

The determination of whether any individual who is treated as an employee holds a position substantially similar to the position held by an individual whom the taxpayer would otherwise be permitted to treat as other than an employee for employment tax purposes under section 530(a) of the 1978 Act requires an examination of all the facts and circumstances, including particularly the activities and functions performed by the individuals. Differences in the positions held by the respective individuals that result from the taxpayer's treatment of one individual as an employee and the other individual as other than an employee (for example, that the former individual is a participant in the taxpayer's qualified pension plan or health plan and the latter individual is not a participant in either) are to be disregarded in determining whether the individuals hold substantially similar positions.

Section 1706(a) of the 1986 Act added to section 530 of the 1978 Act a new subsection (d), which provides an exception with respect to the treatment of certain workers. Section 530(d) provides that section 530 shall not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work. Section 530(d) of the 1978 Act does not affect the determination of whether such workers are employees under the common law rules. Rather, it merely eliminates the employment tax relief under section 530(a) of the 1978 Act that would otherwise be available to a taxpayer with respect to those workers who are determined to be employees of the taxpayer under the usual common law rules. Section 530(d) applies to remuneration paid and services rendered after December 31, 1986.

The Conference Report on the 1986 Act discusses the effect of section 530(d) as follows:

The Senate amendment applies whether the services of [technical service workers] are provided by the firm to only one client during the year or to more than one client, and whether or not such individuals have been designated or treated by the technical services firm as independent contractors, sole proprietors, partners, or employees of a personal service corporation controlled by such individual. The effect of the provision cannot be avoided by claims that such technical service personnel are employees of personal service corporations controlled by such personnel. For example, an engineer retained by a technical services firm to provide services to a manufacturer cannot avoid the effect of this provision by organizing a corporation that he or she controls and then claiming to provide services as an employee of that corporation.

. . . [T]he provision does not apply with respect to individuals who are classified, under the generally applicable common law standards, as employees of a business that is a client of the technical services firm.

2 H.R. Rep. No. 99-841 (Conf. Rep.), 99th Cong., 2d Sess. II-834 to 835 (1986).

Under the facts of Situation 1, the legal relationship is between the Firm and the Individual, and the Firm retains the right of control to insure that the services are performed in a satisfactory fashion. The fact that the Client may also exercise some degree of control over the Individual does not indicate that the individual is not an employee. Therefore, in Situation 1, the Individual is an employee of the Firm under the common law rules. The facts in Situation 1 involve an arrangement among the Individual, Firm, and Client, and the services provided by the Individual are technical services. Accordingly, the Firm is denied section 530 relief under section 530(d) of the 1978 Act (as added by section 1706 of the 1986 Act), and no relief is available with respect to any employment tax liability incurred in Situation 1.

The analysis would not differ if the facts of Situation 1 were changed to state that the Individual provided the technical services through a personal service corporation owned by the Individual.

In Situation 2, the Firm does not retain any right to control the performance of the services by the Individual and, thus, no employment relationship exists between the Individual and the Firm.

In Situation 3, the Firm does not control the performance of the services of the Individual, and the Firm has no right to affect the relationship between the Client and the Individual. Consequently, no employment relationship exists between the Firm and the Individual.

**HOLDINGS**

*Situation 1.* The Individual is an employee of the Firm under the common law rules. Relief under section 530 of the 1978 Act is not available to the Firm because of the provisions of section 530(d).

*Situation 2.* The Individual is not an employee of the Firm under the common law rules.

*Situation 3.* The Individual is not an employee of the Firm under the common law rules.

Because of the application of section 530(b) of the 1978 Act, no inference should be drawn with respect to whether the Individual in Situations 2 and 3 is an employee of the Client for federal employment tax purposes.

# VIZCAINO v. MICROSOFT CORPORATION



**United States Court of Appeals,Ninth Circuit.**

**Donna VIZCAINO; Jon R. Waite; Mark Stout; Geoffrey Culbert; Lesley Stuart; Thomas Morgan; Elizabeth Spokoiny; Larry Spokoiny, Plaintiffs-Appellants, v. MICROSOFT CORPORATION, and its pension and welfare benefit plans, et al., Defendants-Appellees.**

**No. 94-35770.**

**Decided: October 3, 1996**

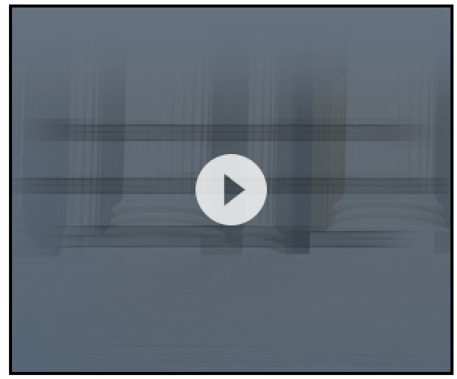
Before: REINHARDT and TROTT, Circuit Judges, and SCHWARZER, District Judge.* Stephen K. Strong and David F. Stobaugh, Bendich, Stobaugh & Strong, Seattle, WA, for plaintiffs-appellants. James D. Oswald and Timothy St. Clair Smith, Davies, Roberts & Reid, Seattle, WA, for defendants-appellees.

Large corporations have increasingly adopted the practice of hiring temporary employees or independent contractors as a means of avoiding payment of employee benefits, and thereby increasing their profits. This practice has understandably led to a number of problems, legal and otherwise. One of the legal issues that sometimes arises is exemplified by this lawsuit. The named plaintiffs, who were classified by Microsoft as independent contractors, seek to strip that label of its protective covering and to obtain for themselves certain benefits that the company provided to all of its regular or permanent employees. After certifying the named plaintiffs as representatives of a class of "common-law employees," the district court granted summary judgment to Microsoft on all counts. The named plaintiffs and the class they represent now appeal as to two of their claims: a) the claim, made pursuant to section 502(a) of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1132(a), that they are entitled to savings benefits under Microsoft's Savings Plus Plan (SPP); and b) the claim, made pursuant to Washington state law, that they are entitled to stock-option benefits under Microsoft's Employee Stock Purchase Plan (ESPP). In both cases, the claims are based on their contention that they are common-law employees.

I

Microsoft, one of the country's fastest growing and most successful corporations and the world's largest software company, produces and sells computer software internationally. It employs a core staff of permanent employees. It categorizes them as "regular employees" and offers them a wide variety of benefits, including paid vacations, sick leave, holidays, short-term disability, group health and life insurance, and pensions, as well as the two benefits involved in this appeal. Microsoft supplements its core staff of employees with a pool of individuals to whom it refuses to pay fringe benefits. It previously classified these individuals as "independent contractors" or "freelancers," but prior to the filing of the action began classifying them as "temporary agency employees." Freelancers were hired when Microsoft needed to expand its workforce to meet the demands of new product schedules. The company did not, of course, provide them with any of the employee benefits regular employees receive.

The named plaintiffs worked for Microsoft in the United States between 1987 and 1990 as freelancers in the company's international division.[1] Some were still working for the company when the suit was filed in 1993, and may still be doing so today. Although hired to work on specific projects, seven of the eight named plaintiffs had worked on successive projects for a minimum of two years prior to the time the action was filed, while the eighth had worked for more than a year. During that time, they performed services as software testers, production editors, proofreaders, formatters and indexers. Microsoft fully integrated the plaintiffs into its workforce: they often worked on teams along with regular employees, sharing the same supervisors, performing identical functions, and working the same core hours. Because Microsoft required that they work



on site, they received admittance card keys, office equipment and supplies from the company.



Freelancers and regular employees, however, were not without their obvious distinctions. Freelancers wore badges of a different color, had different electronic-mail addresses, and attended a less formal orientation than that provided to regular employees. They were not permitted to assign their work to others, invited to official company functions, or paid overtime wages. In addition, they were not paid through Microsoft's payroll department. Instead, they submitted invoices for their services, documenting their hours and the projects on which they worked, and were paid through the accounts receivable department.

The plaintiffs were told when they were hired that, as freelancers, they would not be eligible for benefits. None has contended that Microsoft ever promised them any benefits individually. All eight named plaintiffs signed "Microsoft Corporation Independent Contractor Copyright Assignment and Non-Disclosure Agreements" (non-disclosure agreements) as well as companion documents entitled "Independent Contractor/Freelancer Information" (information documents) when first hired by Microsoft or soon thereafter. The non-disclosure agreement, a three-page document primarily concerned with confidentiality, included a provision that states that the undersigned "agrees to be responsible for all federal and state taxes, withholding, social security, insurance and other benefits." The information document likewise states that "as an Independent Contractor to Microsoft, you are self-employed and are responsible to pay all your own insurance and benefits." Eventually, the plaintiffs learned of the various benefits being provided to regular employees from speaking with them or reading various Microsoft publications concerning employee benefits.

In 1989 and 1990, the Internal Revenue Service (IRS) examined Microsoft's employment records to determine whether the company was in compliance with the tax laws. Applying common-law principles defining the employer-employee relationship, it concluded that Microsoft's freelancers were not independent contractors but employees for withholding and employment tax purposes, and that Microsoft would thereafter be required to pay withholding taxes and the employer's portion of Federal Insurance Contribution Act (FICA) tax.[2] Microsoft agreed to pay overdue employer withholding taxes and issue retroactive W-2 forms to allow the freelancers to recover Microsoft's share of FICA taxes, which they had been required to pay. It apparently also agreed to pay freelancers retroactively for any overtime they may have worked.

In response to the IRS rulings, Microsoft began "converting" its freelancers. That is, it tendered offers to some freelancers to become permanent employees; it gave other freelancers the option of terminating their employment relationship with Microsoft completely or continuing to work at the company but in the capacity of employees of a new temporary employment agency, which would provide payroll services, withhold federal taxes, and pay the employer's portion of FICA taxes. Most of the plaintiffs who were not given the opportunity to become permanent employees decided to become "temporary agency employees" rather than to be fired. However, Donna Vizcaino refused that option and was discharged. Those who elected "temporary employee status" noticed little change in the terms or conditions of their employment; they continued working the same hours on the same projects and under the same supervisors.

After learning of the IRS rulings, the plaintiffs sought various employee benefits, including those now at issue: the ESPP and SPP benefits. The SPP, which became effective January 1, 1987, is a cash or deferred salary arrangement under § 401k of the Internal Revenue Code that permits Microsoft's employees to save and invest up to fifteen percent of their income through tax-deferred payroll deductions. Under the plan, Microsoft matches fifty percent of the employee's contribution in any year, with a maximum matching contribution of three percent of the employee's yearly compensation. The ESPP, established in January, 1986, permits employees to purchase company stock at eighty-five percent of the lower of the fair market value on the first or on the last day of each six-month offering period through payroll deductions of from two to ten percent. Employees may purchase shares having a value not exceeding ten percent of their gross compensation for the offering period.

Microsoft rejected the plaintiffs' claims for benefits, maintaining that they were independent contractors who were personally responsible for all their own benefits. The plaintiffs sought review of the denial of benefits from the Microsoft plan administrator, who determined that the plaintiffs were ineligible because they contractually waived any rights to benefits and, in any event, they were not " 'regular, full time employees' in approved headcount positions." Although ruling "technically" only on the denial of ERISA benefits, the plan administrator concluded, for the same reasons, that the plaintiffs were ineligible to receive non-ERISA benefits.

The named plaintiffs brought this action, challenging the denial of benefits. Following cross-motions for summary judgment, the district court referred the matter to Magistrate Judge David E. Wilson, who recommended that an award be made in favor of the plaintiffs on both their SPP and ESPP claims. First, he concluded that the SPP was ambiguous with respect to whether it afforded coverage to the plaintiffs and that because the ambiguity could not be conclusively resolved by resort to extrinsic evidence, the doctrine of contra proferentem was applicable. Accordingly, he determined that the plan instruments should be construed in the plaintiffs' favor and recommended that the district court find that the plan afforded them coverage. Second, he concluded that by expressly adopting the conditions of the Internal Revenue Code, which permit tax qualification only to those plans that extend participation to all common-law employees, Microsoft had extended an offer of participation in the ESPP to all common-law employees, and that the plaintiffs fell into that category. Further, he found that although Microsoft had intended to exclude freelancers from participation in the ESPP, it had made the plaintiffs an offer in that plan and could not rely on their failure to accept it because it had incorrectly told them that they were ineligible to participate. Again, the magistrate judge recommended that the district court find that the plaintiffs were eligible for benefits.

The magistrate judge also made recommendations on several motions relating to benefits other than the SPP and ESPP. Specifically, he recommended denying the plaintiffs' motion for summary judgment in relation to vacation, sick leave, holidays, short-term disability, group health and life insurance, and granting Microsoft's motion for summary judgment on all claims governed by ERISA, except the SPP claim, and on all claims governed by state law, except the ESPP claim.

The district court adopted the magistrate judge's recommendations on all issues other than the SPP and ESPP claims. It rejected his recommendations as to those two claims and denied the plaintiffs' motion for summary judgment as to them, while granting Microsoft's. The district court first concluded that the SPP "clearly restricts participation to those individuals on Microsoft's payroll," that even if Microsoft could waive the argument that only employees paid through the payroll were eligible it had not done so, and that because the intent of the parties was to deny the plaintiffs participation, the terms of the plan were susceptible to only one reasonable interpretation. Thus, it said, the doctrine of contra proferentem was not applicable. Then, addressing the plaintiffs' eligibility to participate in the ESPP, the district court concluded:

First, the contract between Microsoft and the plaintiffs specifically stated that no benefits were provided by Microsoft. Second, because the terms of the plan were not communicated to the plaintiffs, they could not have become part of the contract between them and Microsoft. Thus, the plaintiffs had no expectation of receiving any benefits. Finally, as Microsoft asserts, I.R.C. § 423 does not create a private right of action by the plaintiffs against Microsoft.

The named plaintiffs and the class they represent appeal, but only with respect to the SPP and ESPP claims.

II

ERISA is a remedial statute designed to protect the interests of employees in pension and welfare benefit plans. Scott v. Gulf Oil Corp., 754 F.2d 1499, 1501 (9th Cir.1985). It creates a federal cause of action for recovery of benefits due under the terms of pension and welfare plans. 29 U.S.C. § 1132(a)(1)(B).3 Congress intended the courts to fashion a body of federal common law to govern ERISA suits. Richardson v. Pension Plan of Bethlehem Steel, 67 F.3d 1462, 1465 (9th Cir.1995); Scott, 754 F.2d at 1501-02. Courts, therefore, may borrow from state law where appropriate, but must be guided by the policies expressed in ERISA and other federal labor laws. Richardson, 67 F.3d at 1465; Scott, 754 F.2d at 1502.

The parties agree that the SPP is a welfare benefits plan governed by ERISA. See 29 U.S.C. § 1002(1)(A). They disagree, however, on the question whether the plaintiffs qualify for benefits under the terms of the plan. The SPP provides that "[e]ach employee who is 18 years of age or older and who has been employed for six months shall be eligible to participate in this Plan," and defines "employee" to mean "any common-law employee who receives remuneration for personal services rendered to the employer and who is on the United States payroll of the employer." (Emphasis added). Because the named plaintiffs were indisputably over eighteen years of age and were employed for more than six months, and because, as Microsoft concedes, they were generally common-law employees who rendered personal services to Microsoft,4 the issue before us is only whether they were "on the United States payroll of the employer." Microsoft contends that the phrase, which is not defined in the plan, refers to employees paid through its payroll department, and that the named plaintiffs were ineligible to participate in the SPP because they were paid through the accounts receivable department. The plaintiffs assert that the phrase refers to "Microsoft employees who are paid from United States sources," excluding "nonresident alien employees of foreign subsidiaries whose pensions are generally governed by foreign law."

In the usual case, we review a denial of benefits challenged under section 1132(a)(1)(B) de novo "unless the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan." Nelson v. EG & G Energy Measurements Group, Inc., 37 F.3d 1384, 1388 (9th Cir.1994).5 Where such discretion is afforded, the standard of review may vary with the type or nature of the plan. Taft v. Equitable Life Assurance Soc'y, 9 F.3d 1469, 1474 (9th Cir.1993) (stating that we review decisions of administrators who are also employers of plan beneficiaries under " 'a more stringent version of the abuse of discretion standard' ") (citation omitted).

In the case before us, the administrator is a Microsoft officer. We need not, however, determine what standard would ordinarily be applicable to review of a denial of benefits under the SPP. For, while the plan gives the administrator discretion to construe its provisions, in denying the plaintiffs' claims the administrator did not construe the phrase "on the United States payroll of the employer," the phrase in the plan on which eligibility depends. Oddly, Microsoft did not raise its "United States payroll" theory before the plan administrator but argued it for the first time to the magistrate judge in the course of its motion for summary judgment.6 The plaintiffs initially objected to consideration of the “United States payroll” argument because it did not appear in the administrative record, but then waived the objection and, like Microsoft, urged the magistrate judge and the district judge to address it. Both parties have consistently maintained that a remand to the plan administrator would serve no useful purpose. See CR Vol. 12, Document 152, at 22-23; CR. Vol. 12, Document 169, at 12 n. 11. Because both parties urged the district court, and now this court, to determine the meaning of the disputed provision, they have waived any possible objection to the failure to remand. Accordingly, we are free to decide Microsoft's latest argument in the normal course, as if the plan administrator had no discretion to construe the plan. Cf. Nelson, 37 F.3d at 1389 (holding that our review is de novo where the plan administrator, although having discretion to construe the plan, has not done so).7

We interpret the provisions of a plan by looking to its terms and to other manifestations of intent. Nelson, 37 F.3d at 1389. We interpret terms in ERISA plans “ ‘in an ordinary and popular sense as would a [person] of average intelligence and experience.’ ” Richardson, 67 F.3d at 1465 (quoting Evans v. Safeco Life Ins. Co., 916 F.2d 1437, 1441 (9th Cir.1990)); Babikian v. Paul Revere Life Ins. Co., 63 F.3d 837, 840 (9th Cir.1995); accord Meredith v. Allsteel, Inc., 11 F.3d 1354, 1358 (7th Cir.1993). “ ‘We will not artificially create ambiguity where none exists. If a reasonable interpretation favors the insurer and any other interpretation would be strained, no compulsion exists to torture or twist the language of the policy.’ ” Babikian, 63 F.3d at 840 (quoting Evans, 916 F.2d at 1441 (quoting Allstate Ins. Co. v. Ellison, 757 F.2d 1042, 1044 (9th Cir.1985))). We find “[a] term is ambiguous if it is subject to reasonable alternative interpretations.” Hickey v. A.E. Staley Mfg., 995 F.2d 1385, 1389 (7th Cir.1993) (citation and internal quotation marks omitted); see Babikian, 63 F.3d at 840.

When a plan is ambiguous on its face, we may, and typically do, consider extrinsic evidence to interpret it. Richardson, 67 F.3d at 1466; Hickey, 995 F.2d at 1389. If the ambiguity persists even after resort to extrinsic evidence, we generally apply the rule of contra proferentem and construe the ambiguity against the drafter. See Barnes v. Independent Auto. Dealers of Cal., 64 F.3d 1389, 1393 (9th Cir.1995) (“We must construe ambiguities in an ERISA plan against the drafter and in favor of the insured.”); Babikian, 63 F.3d at 840; Mongeluzo v. Baxter Travenol Long Term Disability Benefit Plan, 46 F.3d 938, 942 (9th Cir.1995) (noting that Kunin v. Benefit Trust Life Ins. Co., 910 F.2d 534, 539-41 (9th Cir.), cert. denied, 498 U.S. 1013, 111 S.Ct. 581, 112 L.Ed.2d 587 (1990), adopted the well-established doctrine of contra proferentem as federal common law).

Accordingly, our first task is to determine whether the phrase “on the United States payroll of the employer” is susceptible to more than one reasonable interpretation. In doing so, we must examine the phrase in light of any relevant circumstances that may shed light on its meaning. Here, the phrase is used in connection with a company that is engaged in a constantly expanding business venture of major proportions on a world-wide basis. Because “payroll” means “a list of persons to be paid, with the amount due each,” or “the total number of people employed by a business firm or organization,” Random House College Dictionary 976 (1980), the phrase “on the United States payroll of the employer,” when accorded its ordinary meaning, may plausibly refer to those persons who are on the list of, or are among the total number of, persons employed by Microsoft and paid from its United States accounts, as opposed to those paid by its foreign subsidiaries or out of its foreign accounts. Thus, we believe that the plan, consistent with the ordinary meaning of its terms, reasonably can be read to extend eligibility to the plaintiffs.8

While an argument could well be made that the plaintiffs' is the only plausible reading of the plan, we choose not to rely on that assertion. Instead, we assume that Microsoft's interpretation is also a reasonable one, and accept its contention that the phrase could reasonably be construed to refer only to those employees paid through the payroll department. Assuming, then, that the terms of the SPP are susceptible to two reasonable interpretations and therefore are ambiguous, our next step is to determine whether the ambiguity can be resolved by resort to extrinsic evidence.

Microsoft contends that the extrinsic evidence, including the non-disclosure agreements and the information documents, demonstrates its intent not to provide freelancers or independent contractors with employee benefits and that this intent necessitates adoption of its interpretation of the disputed phrase. We have no doubt that the company did not intend to provide freelancers or independent contractors with employee benefits, and that if the plaintiffs had in fact been freelancers or independent contractors, they would not be eligible under the plan. The plaintiffs, however, were not freelancers or independent contractors. They were common-law employees,9 and the question is what, if anything, Microsoft intended with respect to persons who were actually common-law employees but were not known to Microsoft to be such. The fact that Microsoft did not intend to provide benefits to persons who it thought were freelancers or independent contractors sheds little or no light on that question. To the extent that we may glean any evidence of an intent as to the more pertinent theoretical question, that evidence is highly speculative and would be insufficient to resolve in Microsoft's favor the ambiguity that it created when it chose to define eligibility in terms of common-law employees “on the United States payroll of the employer.”

Microsoft also contends that extrinsic evidence establishes its intent to restrict eligibility to those common-law employees who were paid through the payroll department. It argues that compliance with relevant tax code provisions (I.R.C. §§ 401(k) & (m)) required computation of compensation, deferral, and matching contribution data, and that the necessary computations could practically be made only through its automated payroll department. It maintains that employees who were paid through the accounts receivable department, as opposed to the payroll department, could not be paid in a manner that would comply with IRS requirements and that, accordingly, it is clear that those employees were not intended to be covered in the plan.

Microsoft's argument, drawing a distinction between common-law employees on the basis of the manner in which they were paid, is subject to the same vice as its more general argument. Microsoft regarded the plaintiffs as independent contractors during the relevant period and learned of their common-law-employee status only after the IRS examination. They were paid through the accounts receivable department rather than the payroll department because of Microsoft's mistaken view as to their legal status. Accordingly, Microsoft cannot now contend that the fact that they were paid through the accounts receivable department demonstrates that the company intended to deny them the benefits received by all common-law employees regardless of their actual employment status. Indeed, Microsoft has pointed to no evidence suggesting that it ever denied eligibility to any employees, whom it understood to be common-law employees, by paying them through the accounts receivable department or otherwise.

In any event, to interpret the SPP as distinguishing between common-law employees who were paid through the payroll department and those who were not would impute to Microsoft an unlawful purpose: to pay some common-law employees without making the requisite payroll deductions and contributions, the very tax violation that subsequently engendered this litigation. We should not, if at all possible, favor an interpretation that has such an unlawful effect, and we see no reason to do so here. See Meredith v. Allsteel, Inc., 11 F.3d 1354, 1358 (7th Cir.1993) ("[A]n interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect [.]") (citation and internal quotation marks omitted). Thus, the extrinsic evidence on which Microsoft relies does not resolve the ambiguity in its favor.

In light of the rule of contra proferentem, the plaintiffs would prevail whether the extrinsic evidence supported their interpretation of the disputed phrase or whether the extrinsic evidence on which they rely was also deemed immaterial. For purposes of our disposition, we may assume the latter to be the case. With that assumption in mind, we find, as did the magistrate judge, that "the correct meaning of the terms in question, given the record and the agreed upon facts in this case, cannot be determined by resort to the extrinsic evidence," and that, therefore, the rule of contra proferentem is applicable.

Microsoft contends that the rule of contra proferentem should not be applied in this case because it has been applied generally in ERISA cases only for the purpose of granting benefits under insurance contracts. Microsoft is incorrect. It is true that the rule of contra proferentem, which is strictly applied in the interpretation of insurance contracts, is not automatically applied to all other contracts. Eley v. Boeing Co., 945 F.2d 276, 280 (9th Cir.1991). We have declined to apply the rule to "ERISA plans that are the product of collective bargaining agreements reached after arms-length bargaining between parties of equal power." Patterson v. Hughes Aircraft Co., 11 F.3d 948, 950 n. 3 (9th Cir.1993); see Eley, 945 F.2d at 280 (distinguishing Kunin because the plan was the result of a collective bargaining agreement); see also Kunin, 910 F.2d at 540. This case does not involve such a plan, and we see no reason to create a new exception to the rule we generally follow in ERISA cases. See Barnes, 64 F.3d at 1393.

We have also held that when an administrator has exercised his discretion to construe a plan pursuant to discretionary authority vested in him by the plan, we will not apply the rule of contra proferentem in our review of his discretionary ruling. Winters v. Costco Wholesale Corporation, 49 F.3d 550, 554 (9th Cir.1995). Microsoft argues that this case falls within this exception. Clearly, it would be inconsistent to review under an abuse of discretion standard and then to apply the rule of contra proferentem. However, as we explained earlier, the administrator did not construe the disputed terms of the plan, and therefore our review is de novo. When we review under a de novo standard, there is no similar inconsistency, and thus no reason not to apply the rule of contra proferentem.

Accordingly, we agree with the magistrate judge, who concluded that Microsoft, "[a]s the drafter of the plan, . could easily have accomplished the limitation it now urges through the use of more explicit language." We therefore construe the ambiguity in the plan against Microsoft and hold that the plaintiffs are eligible to participate under the terms of the SPP. We note that in doing so, we construe the phrase "on the United States payroll of the employer" in the manner we believe to be the most plausible anyway. Put more directly, were we not to apply the rule of contra proferentem, but simply to select the more reasonable of the competing interpretations, we would read the disputed phrase as do the plaintiffs. Thus, we would conclude in any event that the plan must be construed as extending participation to all persons employed by Microsoft and paid from its United State accounts, and not as excluding from participation those employees who are paid through the accounts receivable department rather than the payroll department.

III

The parties agree that the plaintiffs' claims for stock-option benefits under the ESPP are not subject to ERISA but rather are governed by Washington state law. The plaintiffs contend that the ESPP, through its incorporation of § 423 of the Internal Revenue Code, extended eligibility to participate in the plan to all common-law employees, including themselves, and that they were therefore entitled to exercise the options. Microsoft contends that the plaintiffs are not entitled to ESPP benefits because: (1) the plaintiffs have no right to enforce § 423; (2) the plaintiffs signed instruments stating that they would receive no benefits; and (3) the ESPP was never communicated to the plaintiffs, and they therefore did not rely on the offer in continuing their employment. We address these contentions in turn.

First, we hold that the named plaintiffs and the class they represent are covered by the specific provisions of the ESPP. We apply the "objective manifestation theory of contracts," which requires us to "impute an intention corresponding to the reasonable meaning of a person's words and acts." Multicare Medical Ctr. v. DSHS, 114 Wash.2d 572, 790 P.2d 124, 133 (1990). Through its incorporation of the tax code provision into the plan, Microsoft manifested an objective intent to make all common-law employees, and hence the plaintiffs, eligible for participation. The ESPP specifically provides:

It is the intention of the Company to have the Plan qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1954. The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that Section of the Code.

(Emphasis added). The requirements of § 423 dictate that "options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation." 26 U.S.C. § 423(b)(4). Because the term "employees" in § 423 is construed to refer to "common-law employees,"[10] the ESPP, when construed in a manner consistent with the requirements of § 423, extends participation to all common-law employees not covered by one of the express exceptions set forth in the plan.[11] Accordingly, we find that the ESPP, through its incorporation of § 423, expressly extends eligibility for participation to the plaintiff class and affords them the same options to acquire stock in the corporation as all other employees.

Microsoft argues that § 423 does not grant the plaintiffs a private right of enforcement. We conclude, as did the magistrate judge, that Microsoft's argument is without merit. This case is not about a private right of action. It is about the construction of the terms of a plan. As the magistrate judge cogently stated,

Plaintiffs do not contend that § 423, per se, provides them with a private right of enforcement. What they do contend is that Microsoft expressly incorporated § 423's terms into its ESPP, thereby making an offer to its employees, including its "common law employees," a classification in which they belonged.

Because the plan, properly construed, extends participation to all common-law employees, the plaintiffs may enforce the plan in the same manner as would any of Microsoft's other employees. They may, and did, assert a cause of action for breach of contract, not for violation of the Internal Revenue Code.[12]

Microsoft next contends that the non-disclosure agreements and the information documents signed by the plaintiffs render them ineligible to participate in the ESPP. First, the label used in the instruments signed by the plaintiffs does not control their employment status.[13] Second, the employment instruments, if construed to exclude the plaintiffs from receiving ESPP benefits, would conflict with the plan's express incorporation of § 423. Although Microsoft may have generally intended to exclude individuals who were in fact independent contractors, it could not, consistent with its express intention to extend participation in the ESPP to all common-law employees, have excluded the plaintiffs. Indeed, such an exclusion would defeat the purpose of including § 423 in the plan, because the exclusion of common-law employees not otherwise excepted would result in the loss of the plan's tax qualification.

Moreover, we find nothing inconsistent between the employment instruments signed by the plaintiffs, and an offer of participation in the ESPP. The statements in those instruments that speak in terms of the employee being "responsible for . other benefits" or "responsible to pay all [his] own insurance and benefits" apply most naturally to health and welfare benefits, or similar employee protection policies, which an employee would have to pay on his own if the employer did not provide the benefits. In fact, we find the instruments fully consistent with the plaintiffs' participation in the ESPP, because, under the terms of the plan, it is the employee who makes the stock option payment, not Microsoft. Thus, it is the employee who is "responsible" for paying for the benefit. Accordingly, even if the incorporation of § 423 did not override the instruments signed by the plaintiffs, we would conclude that nothing in those instruments serves to waive or otherwise foreclose the plaintiffs' eligibility for participation in the ESPP.[14]

Finally, Microsoft maintains that the plaintiffs are not entitled to ESPP benefits because the terms of the plan were never communicated to them and they were therefore unaware of its provisions when they performed their employment services. As a preliminary matter, we find Microsoft's reliance on policy manual cases such as Kimbro v. Atlantic Richfield Company, 889 F.2d 869, 879 (9th Cir.1989), to be misplaced. In Kimbro, we stated that under Washington precedent, an employer may be contractually bound by promises in employee handbooks or manuals to provide specific treatment in specific situations only if an employee can show that the promise induced his reliance-that is, "that the promise induced him to remain on the job or not seek other employment." 889 F.2d at 879 (quoting Thompson v. St. Regis Paper Co., 102 Wash.2d 219, 685 P.2d 1081, 1088 (1984)). However, many policy manuals are primarily designed for internal guidance and such manuals are far different in nature and legal effect than tax-qualified benefit plans that fix the rights of their beneficiaries.15

In any event, to the extent that knowledge of an offer of benefits is a prerequisite, it is probably sufficient that Microsoft publicly promulgated the plan. In Dangott v. ASG Industries, Inc., 558 P.2d 379, 382 (Okla.1976), the plaintiff was unaware of the company's severance plan until shortly before his termination. The Oklahoma Supreme Court concluded nonetheless that publication of the plan was "the equivalent of constructive knowledge on the part of all employees not specifically excluded." Id. at 383 (emphasis added).16 Here, the plaintiffs knew of the plan but were wrongly told by Microsoft that it did not apply to them. We are not aware of any Washington case involving a similar set of circumstances, but think it likely that if presented with the question, the Washington Supreme Court would adopt the Dangott approach, at least under the circumstances presented in this case.

Microsoft itself recognizes "the key distinction between offers actually made to a class of employees, as to which some courts enforce the offer on behalf of any class member, regardless of individual knowledge of the offer, and plans as to which no offer is made to the class, and the class is expressly notified no offer is being made." (Emphasis added). Here, the plan was distributed to Microsoft employees generally. By its terms, the plan extends participation to the class of common-law employees, and hence offers ESPP benefits to all members of that class.17 Thus, applying the "key" distinction recognized by Microsoft, an offer was actually made to a class of employees of which the plaintiffs were a part, and it may be enforced on their behalf regardless of their individual knowledge regarding the offer.

We are not required to rely, however, on the Dangott analysis or even on Microsoft's own unwitting concession. There is a compelling reason, implicit in some of the preceding discussion, that requires us to reject the company's theory that the plaintiffs' entitlement to ESPP benefits is defeated by their previous lack of knowledge regarding their rights. It is "well established" that an optionor may not rely on an optionee's failure to exercise an option when he has committed any act or failed to perform any duty "calculated to cause the optionee to delay in exercising the right." 17A Am.Jur.2d Contracts § 85 (1991 & Supp.1996). "[T]he optionor may not make statements or representations calculated to cause delay, [or] fail to furnish [necessary] information." Id. Similarly, "[I]t is a principle of fundamental justice that if a promisor is himself the cause of the failure of performance, either of an obligation due him or of a condition upon which his own liability depends, he cannot take advantage of the failure." Highlands Plaza, Inc. v. Viking Investment Corp., 72 Wash.2d 865, 435 P.2d 669, 676 (1967) (quoting 5 Williston on Contracts § 677 (3d ed. 1961)); James S. Black & Co. v. P & R Co., 12 Wash.App. 533, 530 P.2d 722, 724 (1975) (same); Refrigeration Eng'g Co. v. McKay, 4 Wash.App. 963, 486 P.2d 304, 309 (1971) (same); see Restatement of Contracts § 295 (1932).

Applying these principles, we agree with the magistrate judge, who concluded that Microsoft, which created a benefit to which the plaintiffs were entitled, could not defend itself by arguing that the plaintiffs were unaware of the benefit, when its own false representations precluded them from gaining that knowledge. Because Microsoft misrepresented both the plaintiffs' actual employment status and their eligibility to participate in the ESPP, it is responsible for their failure to know that they were covered by the terms of the offer. It may not now take advantage of that failure to defeat the plaintiffs' rights to ESPP benefits. Thus, we reject Microsoft's final argument.

CONCLUSION

For the reasons stated, the district court's grant of summary judgment in favor of Microsoft and denial of summary judgment in favor of the plaintiffs is REVERSED and the case REMANDED for the determination of any questions of individual eligibility for benefits that may remain following issuance of this opinion and for calculation of the damages or benefits due the various class members.

REVERSED and REMANDED.

I

The Savings Plus Plan

Microsoft has a payroll department, and it has a separate accounts payable department. Because these plaintiffs were regarded both by Microsoft and by themselves as independent contractors or freelancers, Microsoft did not budget or pay for them through the payroll department, but through the accounts payable department. This commonplace distinction is fatal to the plaintiff's request for Savings Plus Plan ("SPP") benefits because to be eligible for these benefits, they have to have been on the employer's "payroll." The Plan itself so states.

As freelancers, the plaintiffs worked for Microsoft with the clear understanding that they were not entitled to the benefits they now seek. They knew Microsoft paid them based on the submission of invoices and out of accounts payable. Nevertheless, they now contend-without a foot to stand on-that they were indeed on Microsoft's "payroll" and thus eligible for SPP benefits. In my reading of this record, they were not on

Microsoft's “payroll,” period. I agree with the district court's analysis. All this may seem formalistic to the casual reader, but it was an important distinction to Microsoft, and to these workers when they agreed as freelancers to perform work for this company.

How the plaintiffs got on Microsoft's payroll budget from the accounts payable department is a strange tale based not on the facts, but on an immaculate patching together by the majority of a series of interpretations, constructions, presumptions, plausibilities, assertions, and assumptions, topped off by an irrelevant definition of “payroll” in a Random House dictionary. This amalgam is driven in turn by an IRS ruling that the majority takes way beyond its necessary reach. The majority's strained and Urbanesque journey belies its claim that it does not create ambiguity where none exists. In the context of this case-forget Random House-“payroll” has an ascertainable meaning illustrated in large measure by the existence in Microsoft of an alternative method of paying people for their work: out of accounts payable. Anyone familiar with business is familiar with this distinction. Where is the ambiguity but in the eyes of uninitiated outsiders? I discern none, and the plaintiffs saw none either when they voluntarily worked under these circumstances.

As the majority indicates, we interpret terms in ERISA plans “in an ordinary and popular sense as would a person of average intelligence and experience,” but we should do so with an eye to what those hypothetical people actually know (e.g., that they did not bargain for the payroll benefits they now seek). To do otherwise is to engage in head-in-the-sand thinking. All the maxims invoked by the majority to support their holdings are useless unless they square with the facts. If I know I have a “no benefits” contract, for example, what good does it do to ask what the ordinary average Babbitt (George, not Bruce) might believe after reading a Random House dictionary? These plaintiffs were university-educated. One had a law degree. They knew what they were getting into, and contra proferentem should not suggest otherwise. The majority's preference for answering this issue as a theoretical rather than a real question is wrong.

But for the sake of argument, we can ignore the contextual definition of “payroll” and concede the existence of an ambiguity created by the words “United States.” Then we can examine extrinsic evidence to see if the plaintiffs have a righteous claim to this benefit. Here, their argument becomes tenuous in the extreme. The plaintiffs have not presented a shred of relevant extrinsic evidence that would justify their belief (after signing the documents they did and after accepting the contractual relationship governing this case) that they were on the payroll and entitled to any of the payroll benefits of regular employees, including the SPP. Plaintiff Vizcaino's answers in her deposition testimony, answers representative of the testimony of all plaintiffs, adequately illustrate this point:

Q. You didn't ask anything [during your initial interview] about the benefits on this job?

A. Well, yeah, I must have I guess. I don't remember what we said but, I guess it- yeah, we weren't going to get benefits at that time.

Q. Okay. And just so we understand each other, when you say benefits-let me rephrase the question. By benefits I assume that you mean, and correct me if I'm wrong, things like holidays, vacation, sick leave, other kinds of paid leave, participation in the employee stock purchase plans, that kind of thing. Is that the way you mean benefits?

A. Yeah.

Q. Okay. Now, at the end of this conversation, this interview with Ms. Carter, I assume it was at the end of the conversation, did you accept the position on the terms that had been discussed in that interview?

A. Yes.

(emphasis added). Equally telling is the deposition testimony of plaintiff Culbert:

Q. Did you ever hear anybody use the term “regular employee” during your time at Microsoft when you were a freelancer?

A. I do recall, yes.

Q. And when that term was used did you understand it to refer to people who were salaried as opposed to freelancers?

A. Yes.

Q. So that until this status change [when Culbert became a regular employee] in October of 1989 you were never a regular employee at Microsoft?

A. I worked at Microsoft consistently.

Q. But you were never what was referred to as a regular employee?

A. That's correct. I was never what was referred to as a regular employee at that time, correct.

Q. And I take it at no time before October of 1989 did you ever apply for benefits of any type from Microsoft: sick leave, vacation, holidays, participation in the employee stock purchase program?

A. I didn't apply for those things.

* * * * * *

Q. But during the course of the next few weeks or months [after beginning work at Microsoft] it became clear to you that being a freelancer meant that you got no benefits?

A. That it meant something, if I may, it meant that in some ways I was different from the regular salaried employees with whom I worked.

Q. But among those ways of which it made [sic] you different was that you got no benefits?

A. Correct.

(emphasis added). In the light of this testimony, this case becomes just another example of litigants trying to force their feet into glass slippers that do not fit. As the magistrate judge correctly observed, these plaintiffs had express contracts for "no benefits."

Why they would accept such an arrangement without benefits is also clear from the record: Microsoft paid them more cash on an hourly basis than regular employees. Plaintiff Culbert explains:

Q. Did you have any understanding at that time [when you became a regular employee of Microsoft] about whether it was common for freelancers to be making more on an hourly basis than the equivalent hourly rate for people who were regular salaried employees?

A. Yes.

Q. What was your understanding?

A. That in general freelance production editor [sic] on a gross cash basis would stand to make more than a regular staff employee.

Nevertheless, the plaintiffs brought this lawsuit pursuing not only SPP and stock purchase benefits, but vacation, sick leave, holidays, short-term disability, and group health and life insurance as well, i.e., the best of both worlds.

With all respect to my colleagues, their atmospheric use of the IRS's determination to shore up their analysis by suggesting Microsoft is a tax cheat is gratuitous and inappropriate. I do not discern on the part of Microsoft an unlawful purpose to violate the tax laws. What the IRS does for the purpose of collecting its due-both early and from the most reliable pocket-need not cast a dark light on a relationship with which both Microsoft and these employees were comfortable. It simply does not follow either from the IRS's ruling or from Microsoft's compliance with it (1) that these plaintiffs were payroll employees or (2) that to deny the plaintiffs' claim gives Microsoft unacceptably unclean hands. To quote the United States General Accounting Office in June of 1996,

[M]any employers struggle in making the [employee/independent contractor] classification decision because of the unclear rules. Until the classification rules are clarified, we are not optimistic that the confusion over who is an independent contractor and who is an employee can be avoided. The Treasury Department characterized the situation in 1991 in the same terms as it used in 1982; namely, that "applying the [20 factor] common law test in employment tax issues does not yield clear, consistent, or satisfactory answers, and reasonable persons may differ as to the correct classification." 1

As the magistrate judge observed, "[p]laintiffs concede that the IRS ruling . is in no way binding on this court." The IRS's familiar aggressive tax collection position and Microsoft's payroll argument can exist independently of each other without doing violence to the law.2

By tone and by choice of words the majority seems subtly to accuse Microsoft of reprehensible conduct towards its workers. Microsoft is identified as "refusing" to pay its workers fringe benefits as though it did something wrong in creating the contractual relationships in this case. Later in the opinion the majority charges Microsoft with "misrepresenting" to the plaintiffs their employment status and with taking advantage of them. They clothe Microsoft with a Dickensian anti-labor attitude. Such characterizations spring full-bloom from the first sentence of the majority's opinion where "avoiding payment of employee benefits" and "increasing profits" foreshadow the negative coloration of the infidel Microsoft's role in this drama. The majority's tone and accusations go against the factual record as developed and described by the magistrate judge in his Report and Recommendation dated April 15, 1994:

Plaintiffs offer the explanation that Microsoft really knew all along that they were regular "employees" entitled to benefits, and hid this entitlement from them by "mislabelling" them as independent contractors or freelancers. This argument is not persuasive. "Mislabelling" as used by Plaintiffs implies a unilateral act by Microsoft which in some way hid their true status from Plaintiffs. In truth, Microsoft was quite open about the terms of its working relationships with Plaintiffs on the subject of employee benefits and each of the Plaintiffs fully understood and accepted those terms.

(emphasis added).

Neither federal nor state law mandates the benefits sought, nor does the applicable collective bargaining agreement. Microsoft was free to offer the benefits in return for work as Microsoft saw fit. Thus, the majority seems to overlook the constitutional right of private parties freely to enter into contracts of their own choice and benefit. It is not for the courts under these circumstances to add clauses to agreements that the parties never contemplated, or to accuse parties of attitudes and behavior of which they are not guilty. Congress designed ERISA to protect benefits workers already had, not to give them benefits for which they did not contract. See 18 U.S.C. § 1001 (Congressional findings and declaration of policy).

II

The Employee Stock Purchase Plan

The plaintiffs' second claim of entitlement is to stock option benefits under Microsoft's Employee Stock Purchase Plan ("ESPP"), a claim we process under the law of the State of Washington. The law in question is the Washington law of contracts.

As with the plaintiffs' first claim, the majority engages in analytical gymnastics to find a contractual right where none exists. No one disputes that the offer made by Microsoft and accepted by the plaintiffs explicitly excluded the ESPP benefits now sought. Plaintiffs freely admit as demonstrated earlier that they never expected when these contracts were formed to receive any such benefits. Microsoft never offered the benefits to the plaintiffs, either bilaterally or unilaterally, the plaintiffs never accepted them, and the plaintiffs never relied on them in any way whatsoever as part of their compensation package. As the magistrate judge found in his Report and Recommendation,

Microsoft indeed offered such benefits to its "regular employees" and described them in employee handbooks issued to regular employees, but not to freelancers. Moreover, it is not contended by any Plaintiff that he/she was ever offered such benefits by any Microsoft spokesperson, or even a handbook, and to the extent that any of them saw the books, they understood that they were not entitled to them.

Thus, without an offer, without acceptance, without consideration, and without a meeting of the minds, the majority creates by operation of law a contractual right on behalf of these plaintiffs that they never even contemplated until this lawsuit began.

This unpredictable result is so radical that it trespasses on Article I, section 10, Clause 1 of the Constitution, which prohibits a state from impairing the obligation of contracts. Neither through legislation nor by judicial act could a state severely transmogrify a contractual obligation in this manner and force one party to it to confer such benefits on the other. The result in this case resembles the thrust of the Minnesota statute struck down by the Supreme Court in Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 98 S.Ct. 2716, 57 L.Ed.2d 727 (1978). In that case, Minnesota had enacted a law requiring certain private employers who provided pension benefits under a plan meeting the qualifications of section 401 of the Internal Revenue Code to provide pension benefits "conspicuously beyond those that [the company] had voluntarily agreed to undertake." Id. at 240, 98 S.Ct. at 2720. The Supreme Court held this statute unconstitutional under the contracts clause (1) because it failed to deal with a "broad, generalized economic or social problem," and (2) because of its narrow aim at only certain employers. The Court noted also in the employer's favor (1) that the employees of Allied Structural never relied on the statutory benefit at issue, and (2) that the statute "compelled the employer to exceed bargained-for expectations and nullified an express term of the pension plan." Id. at 246 n. 18, 98 S.Ct. at 2723 n. 18. Justice Stewart said,

The severity of an impairment of contractual obligations can be measured by the factors that reflect the high value the framers placed on the protection of private contracts. Contracts enable individuals to order their personal and business affairs according to their particular needs and interests. Once arranged, those rights and obligations are binding under the law, and the parties are entitled to rely on them.

Id. at 245, 98 S.Ct. at 2723.3 Because we are bound to apply state law to this dispute, we have no authority to impair the obligation of these contracts either. To do so is tantamount to depriving Microsoft of property without due process of law.

CONCLUSION

The IRS's understandably tough enforcement program not only collects more money for the government, but it now has the unforeseen and unnecessary consequence of forcing employers retroactively to extend to workers optional benefits for which they did not contract. I perceive no need whatsoever to permit the IRS's ruling to spill out of its unique context and to do damage to contracts between companies and workers. The ruling and the contracts can exist independently of each other. Peaceful coexistence simply means that all workers will be made to pay their taxes, no more, no less, and that all workers will get that for which they bargained. Thus, I respectfully dissent.

FOOTNOTES

1. The district court certified a class comprising[a]ll persons employed by Microsoft Corporation in the United States who are denied employee benefits because they are considered independent contractors or employees of third-party employment agencies, but who meet the definition of employees of Microsoft Corporation under the common law.Microsoft did not object to the class certification or contest the determination that freelancers or independent contractors are proper class members but sought to reserve the question as to whether certain specific individuals fell within the class as well as the question of the amounts due class members by way of benefits or damages. See ER at 27. See also infra n. 4.

2. “[B]ased on information received from Microsoft and on information received from a representative sampling of the workers in that job position,” the IRS concluded in one of several letter rulings that because “Microsoft either exercised, or retained the right to exercise, direction over the services performed,” those persons employed as testers were employees of Microsoft “for purposes of the Federal Insurance Contribution Act, the Federal Unemployment Tax Act, and for Collection of Income Tax at the Source on Wages.” The IRS issued similar findings regarding formatters, proofreaders, and production editors.

3. Section 1132(a)(1)(B) provides, in pertinent part, that a “civil action may be brought . by a participant or beneficiary . to recover benefits due to him under the terms of the plan.” (Emphasis added).

4. As the magistrate judge stated in his Report and Recommendations, Microsoft conceded the fact that the named plaintiffs and the class they represent generally were common-law employees. ER at 144, 147-48. See also supra n. 1. Microsoft reserved only the right to object to the employment status of particular plaintiffs during certain periods of their tenure with Microsoft and to contest the amount of damages or benefits to be awarded. CR Vol. 12, Document 152, at 9 n. 5. For example, Microsoft stated that “for some period of time, Plaintiff Morgan performed proofreading services from his home, with an uncertain amount of supervision.” Id. Questions raising legitimate disputes regarding specific individuals' eligibility are left to the district court for resolution following remand.

5. When the plan does not grant the plan administrator discretion to construe its provisions, the district court reviews de novo, and our review is also de novo. Mongeluzo v. Baxter Travenol Long Term Disability Benefit Plan, 46 F.3d 938, 942 (9th Cir.1995).

6. Microsoft prevailed before the plan administrator on the theory that the plaintiffs were not “regular, full-time employees” in “approved headcount positions,” a theory that it has since abandoned.

7. This case is not controlled by Saffle v. Sierra Pacific Power Company, 85 F.3d 455 (9th Cir.1996). There, we held that where a plan administrator misconstrues a plan, the court should not determine whether benefits are to be awarded under a proper construction; instead, it should remand to the plan administrator for it to make a determination under the plan, properly construed. Here, the term that determines the plaintiff's eligibility was not construed at all by the plan administrator. More important, both parties have agreed that a remand would be inappropriate. The parties are, of course, free to waive any right they may have to a construction by a plan administrator.

8. There may be a slight variation on the interpretation set forth above that is equally plausible and would similarly serve to extend eligibility to the plaintiffs. Under that variation, the disputed phrase would be construed as referring to all persons employed by Microsoft in the United States. However, we need not examine that possibility here.

9. The instruments signed by the plaintiffs label them as independent contractors. Those instruments, however, do not control the plaintiffs' employment status. See Daughtrey v. Honeywell, 3 F.3d 1488, 1492 (11th Cir.1993) (“The employment status of an individual for the purposes of ERISA is not determined by the label used in the contract between the parties.”). Accordingly, the label used here does not determine whether the plaintiffs are or are not common-law employees. The record does, and as Microsoft has conceded, the named plaintiffs and those they represent are generally common-law employees.

10. Treasury Regulation § 1.423-1(b) cross-references § 1.421-7(h) for rules relating to the employment relationship. That subsection, in turn, provides that the determination whether an optionee is an employee will be made in accordance with § 3401(c)-1(a), which states that the term “employee” includes every individual performing services for another where the legal relationship between the two is that of employer and employee. Section 31.3401(c)-1(b) summarizes the common-law test of employee, and § 31.3401(c)-1(c)

provides that where the legal relationship exists, the labels used by the parties to describe the relationship are of no consequence.

11. Section 423(b)(4) sets forth four express exceptions. The ESPP incorporates two of them, as follows: [a]ny employee of the Company or any of its subsidiaries who is in the employ of the Company at one of the offering dates is eligible to participate in the Plan, except (a) employees whose customary employment is 20 hours or less per week, and (b) employees whose customary employment is for not more than five months in the calendar year.The plaintiffs fit neither of these exceptions.

12. A similar approach obtains with respect to plans that require compliance with the provisions of ERISA. While Internal Revenue Code provisions and Treasury regulations do not create substantive rights under ERISA, if an ERISA plan explicitly provides that it is to be construed to meet such provisions, courts look to them in determining employee eligibility for participation in the plan. See Crouch v. Mo-Kan Iron Workers Welfare Fund, 740 F.2d 805, 809 (10th Cir.1984) ("Because the pension plan states that it is to be construed to meet the requirements of ERISA, [the participating and vesting rules require the inclusion of a person in plaintiff's position in the plan,] and there are obvious and significant benefits to meeting those requirements, we conclude that we must construe the plan as including plaintiff as a participant."); see also Abraham v. Exxon Corp., 85 F.3d 1126, 1131 (5th Cir.1996) (finding that court could not look to Treasury regulations to determine employee eligibility for participation in an ERISA plan when it did not contain an explicit provision "declaring that it was to be construed to meet the requirements of an ERISA plan").

13. The pertinent Treasury Department regulation provides that[i]f the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like.Treas. Reg. § 31.3401(c)-1(e) (emphasis added). Accordingly, that the instruments describe the plaintiffs as independent contractors and provide that as such they are not entitled to benefits is not controlling.

14. For this reason, Microsoft's reliance on Grimes v. Allied Stores Corporation, 53 Wash.App. 554, 768 P.2d 528, 529 (1989), in which the court considered a conflict between an employment contract and an employment manual, is inapposite.

15. Washington case law regarding pension plans, for example, holds that "[a]n enforceable contract will arise . even though the [employee] does not know the precise terms of the pension agreement." Dorward v. ILWU-PMA Pension Plan, 75 Wash.2d 478, 452 P.2d 258, 260 (1969).

16. See Woolley v. Hoffmann-La Roche, Inc., 99 N.J. 284, 491 A.2d 1257, 1268 n. 10 (1985) ("The implication of the presumption of reliance is that the . provisions became binding the moment the [plan] was distributed. Anyone employed before or after became one of the beneficiaries of those provisions. And if [Toussaint v. Blue Cross & Blue Shield, 408 Mich. 579, 292 N.W.2d 880 (1980) ] is followed, employees neither had to read it, know of its existence, or rely on it to benefit from its provisions."); see also A. Corbin, Contracts § 59 (1963) (suggesting that knowledge of an offer is not necessary to establish acceptance).

17. Microsoft contends that despite promulgation of a plan, no rights are created unless a promise is made directly to the affected employees. The two cases cited by Microsoft in support of this proposition, Estate of Bogley v. United States, 206 Ct.Cl. 695, 514 F.2d 1027 (1975), and Schmidt v. Avco, 15 Ohio App.3d 81, 472 N.E.2d 721, aff'd, 15 Ohio St.3d 310, 473 N.E.2d 822 (1984), are readily distinguishable. In Bogley, a corporate board of directors voted to offer the plaintiff a severance plan but never actually offered it to him. In Schmidt, there was no allegation that the severance pay policy was published or generally distributed to Avco employees. We also reject Microsoft's argument that the plaintiffs represent a separate class. The plaintiff class is a subset of the class of common-law employees as to whom Microsoft failed to honor its promise of benefits. That the plaintiffs were wronged in this manner hardly makes them a separate class for purposes of determining the scope of the promise.

1. General Accounting Office, Pub. No. GAO/T-GGD-96-130, Tax Administration: Issues in Classifying Workers as Employees or Independent Contractors 5 (1996) (statement of Natwar M. Gandhi, Associate Director, Tax Policy and Administration Issues, General Government Division).

2. Because independent contractors have been found by the IRS to have a lower compliance rate than employees in paying their taxes-to the tune of two to three billion dollars a year-the IRS adopted an aggressive enforcement program in 1986 resulting to date in 12,983 Employment Tax Examination Program audits and the reclassification of 527,000 workers. Id.

3. See also Associated Builders & Contractors, Golden Gate Chapter v. Baca, 769 F.Supp. 1537 (N.D.Cal.1991) (holding that municipal legislation requiring contractors to pay minimum wages and benefits in order to receive private building permits unconstitutionally impaired the contractors' collective bargaining contracts).

REINHARDT, Circuit Judge:

Opinion by Judge REINHARDT; Dissent by Judge TROTT.

**PART III. ADMINISTRATIVE, PROCEDURAL, AND MISCELLANEOUS**

26 CFR 601.201: Rulings and determination letters

(Also, Part I, § 401; § 1.401(a)-2.)

Rev. Proc. 2002-21

**SECTION 1. INTRODUCTION**

.01 *Introduction*. This revenue procedure describes steps that may be taken to ensure the qualified status of defined contribution retirement plans maintained by professional employer organizations (PEOs) for the benefit of Worksite Employees. PEOs are also commonly known as employee leasing organizations.

.02 *Potential for plan disqualification.* The employment relationship between workers and the employer maintaining a plan is fundamental to whether a plan is qualified under § 401(a) of the Internal Revenue Code. The determination of whether an employment relationship exists depends on the facts and circumstances of each particular case. If a retirement plan provides benefits for individuals who are not employees of the employer maintaining the plan, the plan does not satisfy the exclusive benefit rule contained in § 401(a)(2), and therefore could be disqualified.

03. *Relief from disqualification of plan.* The Service recognizes the complexity involved in the determination of whether a Worksite Employee is the common law employee of the PEO or the client organization (CO), as well as the need of the PEO, the CO, Worksite Employees, and plan administrators for certainty in this area. Accordingly, this revenue procedure provides a framework under which plans

sponsored by PEOs will not be treated as violating the exclusive benefit rule solely because they provide benefits to Worksite Employees. Under the approach provided in this revenue procedure, a PEO that maintains a defined contribution retirement plan may establish a multiple employer plan that benefits Worksite Employees providing services to COs. For PEOs that do not wish to establish a multiple employer plan, the revenue procedure provides transition rules under which the existing PEO plan will be treated as a qualified plan if it is terminated by a specified date.

**SECTION 2. PURPOSE**

.01 *In general*. The purpose of this revenue procedure is to provide relief with respect to certain defined contribution retirement plans maintained by a PEO ("PEO Retirement Plans") that benefit Worksite Employees.

.02 *Scope of relief.* With regard to PEO Retirement Plans established prior to May 13, 2002, if the requirements of section 5 are met, the Service will not disqualify the PEO Retirement Plan solely on account of an exclusive benefit rule violation under § 401(a)(2) for a plan year beginning before the Compliance Date if that violation results from the PEO Retirement Plan benefitting Worksite Employees who are not the PEO's employees. Relief provided under this revenue procedure applies only with respect to the PEO Retirement Plan for which relief is granted and not to other plans maintained by a CO or the PEO.

.03 *No effect on other law.* The relief provided under this revenue procedure with respect to the provisions of § 401(a) has no effect on the rights of any party under any other law, including Title I of the Employee Retirement Income Security Act of 1974 and other provisions of the Internal Revenue Code.

**SECTION 3. BACKGROUND**

.01 *In general*. An employee leasing arrangement typically involves the interaction among three parties: the PEO, the CO, and the Worksite Employees. In a typical situation, a PEO enters into an agreement with a CO whereby employees become Worksite Employees and continue to provide services to the CO.

*.02 Employment relationship*. The issue of whether a worker is an employee of a particular entity for employment tax purposes is determined by reference to § 3121(d), which incorporates the common law definition of employee. The Supreme Court has also applied this common law definition of employee for purposes of determining whether a worker is an employee entitled to receive benefits under a retirement plan. See Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992). Courts have also found that common law factors are applicable to determine which of two entities is the employer for purposes of retirement plans. The critical issue in determining who is the employer of an individual is which entity has the right to direct and control the individual performing the services. If it is found that the CO, not the PEO, is the employer, the plan maintained by a PEO that benefits Worksite Employees of the CO would fail to satisfy the exclusive benefit rule. See Professional and Executive Leasing, Inc. v. Commissioner, 89 T.C. 225 (1987), aff'd, 862 F.2d 751 (9th Cir. 1988).

.03 *Exclusive benefit rule*. Section 401(a)(2) provides that a trust forming a part of a qualified pension, profit-sharing, or stock bonus plan must be a trust established and maintained by an employer for the exclusive benefit of that employer's employees and their beneficiaries ("exclusive benefit rule"). Therefore, a retirement plan that provides benefits for individuals who are not employees of the employer maintaining the plan (and who are not otherwise treated as employees under rules such as those under § 414) violates the exclusive benefit rule and does not satisfy the requirements of § 401(a).

.04 *Leased employees*. Section 414(n) does not permit PEOs to maintain plans for Worksite Employees who are not the common law employees of the PEO. Section 414(n) deals with individuals who are not common law employees of the entity for which they perform services ("recipient") but who might have to be taken into account in determining whether a retirement plan maintained by the recipient satisfies the requirements of § 401(a). Notice 84-11, 1984-2 C.B. 469, provides questions and answers relating to § 414(n). Section 414(n) addresses the relationship between the recipient and the leased workers, but it does not apply to situations in which a worker is the common law employee of the recipient.

.05 *Multiple employer plan.* Section 413(c) provides rules for the qualification of a plan maintained by more than one employer (i.e., a “multiple employer plan”). Under § 413(c)(2), in determining whether a multiple employer plan complies with the exclusive benefit rule, all employees benefitting under the multiple employer plan are treated as the employees of all employers who maintain the plan. Additionally, an employee’s service with all of the employers participating in the plan is taken into account for purposes of vesting under § 411 and plan participation under § 410(a). <u>See</u>

§ 413(c)(1) and (3). Similarly, for purposes of the contribution and benefit limitations of § 415, an employee's compensation from all employers participating in the plan is taken into account. See § 1.415-1(e)(1) of the Income Tax Regulations. Other rules apply separately to each participating employer and its employees. For example, nondiscrimination testing under § 401(a)(4) and § 401(k), and coverage testing under § 410(b), are performed separately for each employer maintaining the multiple employer plan. See § 1.401(a)(4)-1(c)(4), § 1.413-2(a)(3)(ii) and § 1.401(k)-1(g)(11). Top-heavy requirements under § 416 also apply separately to each employer. See § 1.416-1, Q&A G-2.

**SECTION 4. RELIEF AVAILABLE**

.01 *No disqualification of PEO Retirement Plan.* If a PEO has a PEO Retirement Plan in existence on May 13, 2002, that benefits Worksite Employees, section 5 provides the PEO with the option of either converting the PEO Retirement Plan to a multiple employer plan or terminating the plan. If a PEO timely satisfies the requirements of section 5, the Service will not disqualify its PEO Retirement Plan solely on the grounds that the plan violates or has violated the exclusive benefit rule for plan years beginning before the Compliance Date by benefitting Worksite Employees who are not the PEO's employees.

.02 *Effective Dates.* (1) *Compliance Date*. Except as specifically provided, all remedial actions and other requirements in section 5 must be completed by the Compliance Date. The Compliance Date is the last day of the first plan year of the PEO

Retirement Plan beginning on or after January 1, 2003. For a calendar year plan, the Compliance Date is December 31, 2003.

(2) *PEO Decision Date*. The PEO Decision Date is the date by which the PEO must take specified actions affirming its decision whether to terminate the PEO Retirement Plan or maintain a multiple employer retirement plan that benefits Worksite Employees. The PEO Decision Date is the date that is 120 days after the first day of the plan year beginning on or after January 1, 2003. For a calendar year plan, the PEO Decision Date is May 2, 2003.

.03 *Plan terminations.* For the purpose of determining whether a PEO Retirement Plan or Spinoff Retirement Plan satisfies the qualification requirements in § 401(a) upon plan termination (as described in section 5.06), Worksite Employees may be treated as if they were employees of the PEO.

**SECTION 5. REMEDIAL ACTION REQUIRED**

.01 *In general.* In order to obtain the relief provided in section 4, the plan sponsor of a PEO Retirement Plan must either terminate the PEO Retirement Plan in accordance with section 5.02, or convert the PEO Retirement Plan into a multiple employer plan ("Multiple Employer Retirement Plan") in accordance with section 5.03.

.02 *Termination Option*. (1) *Termination of PEO Retirement Plan*. If a PEO chooses to terminate a PEO Retirement Plan in accordance with this section, the PEO must adopt a resolution of its board of directors (or, if the PEO is not a corporation, it must take comparable binding action, such as a partnership vote) on or before the PEO

Decision Date, providing that the plan will be terminated on or before the Compliance Date. After the date of termination, all assets in the plan's related trust must be distributed as soon as administratively feasible. See Rev. Rul. 89-87, 1989-2 C.B. 81. Consequently, the mere discontinuance of contributions under the PEO Retirement Plan is not a termination of the plan and will not satisfy the requirements of this section.

(2) *Notification of COs*. The PEO must provide notice of the options set forth in section 5.02(3) to each CO that has Worksite Employees with accrued benefits in the PEO Retirement Plan. The PEO must specify in the notice the date by which each CO must notify the PEO of the option it selects. This notice must be sent on or before the PEO Decision Date.

(3) *CO Options*. The PEO must provide each CO with all of the following options:

(a) *Transfer of assets and liabilities to CO plans*. The CO may choose to have the assets and liabilities of the PEO Plan that are attributable to Worksite Employees performing services for the CO transferred to a retirement plan of the CO as provided in section 5.04(1). The transfer of assets and liabilities attributable to Worksite Employees performing services for the CO to the CO's plan must be completed on or before the Compliance Date.

(b) *Spinoff of assets and liabilities to a separate plan and termination of that plan*. The CO may choose to have the assets and liabilities of the PEO Retirement Plan that are attributable to its Worksite Employees spun off to a Spinoff Retirement Plan, which is then terminated, as provided in section 5.04(2). The spinoff and termination must be completed on or before the Compliance Date. Plan assets must be distributed as soon as administratively feasible after the plan termination date.

(4) *CO Decision and Implementation.* The CO must provide notice of the selected option to the PEO by a date specified by the PEO. If a CO fails to timely inform the PEO of the option it selected, the PEO must treat the CO as having selected option 5.02(3)(b) (Spinoff and Termination). The PEO must implement the choice made or deemed made by each CO on or before the Compliance Date.

(5) *Determination Letter request*. The PEO must request determination letters on the termination of the PEO Retirement Plan and the Spinoff Retirement Plan. See section 5.06 of this revenue procedure for further information on determination letters on plan terminations.

.03 *Conversion Option.* (1) *Conversion to Multiple Employer Retirement Plan*. A PEO may choose to convert the PEO Retirement Plan to a Multiple Employer Retirement Plan, effective the first day of the first plan year beginning after the Compliance Date. If the PEO chooses this option, the PEO must satisfy the requirements of section 5.03(2) through (6). In addition, the Multiple Employer Retirement Plan must be adopted by those COs that wish to have Worksite Employees participate in the plan. To the extent that a PEO Retirement Plan is converted into a Multiple Employer Retirement Plan, assets and liabilities will remain in the plan and not be distributed to participants.

(2) *Adoption of Plan Amendments*. The PEO must adopt plan amendments necessary to convert the PEO Retirement Plan to a Multiple Employer Retirement Plan

on or before the PEO Decision Date. The effective date of the plan amendments adopted by the PEO must be no later than the first day of the first plan year beginning after the Compliance Date.

(3) *Notification of COs.* The PEO must provide notice of the options set forth in section 5.03(4) to each CO that has Worksite Employees with accrued benefits in the PEO Retirement Plan. The PEO must specify in the notice the date by which each CO must notify the PEO of the option it selects. This notice must be sent on or before the PEO Decision Date.

(4) *CO Options*. The PEO must provide each CO with all of the following options:

(a) *Adoption of Multiple Employer Retirement Plan*. The CO may adopt the Multiple Employer Retirement Plan. The CO must adopt the Multiple Employer Retirement Plan by the first day of the first plan year beginning after the Compliance Date (or any earlier date as may be specified by the PEO). If a CO chooses this option, the Worksite Employees performing services for the CO may participate in the Multiple Employer Retirement Plan after its adoption by the CO without causing the plan to fail to satisfy the exclusive benefit rule. If a CO has not adopted the Multiple Employer Retirement Plan by the first day of the first plan year beginning after the Compliance Date (or any earlier date as may be specified by the PEO), the Multiple Employer Retirement Plan may not accept contributions after the Compliance Date on behalf of the Worksite Employees performing services for the CO. In that event, the assets and liabilities attributable to the COs must be spun off as soon as administratively feasible to a Spinoff Retirement Plan.

(b) *Transfer of assets and liabilities to CO plans.* The CO may choose to have the assets and liabilities of the PEO Retirement Plan that are attributable to its Worksite Employees transferred to a retirement plan of the CO as provided in section 5.04(1). The transfer must be completed on or before the Compliance Date.

(c) *Spinoff of assets and liabilities to a separate plan and termination of that plan*. The CO may choose to have the assets and liabilities of the PEO Retirement Plan that are attributable to its Worksite Employees spun off to a Spinoff Retirement Plan that is then terminated, as provided for in section 5.04(2). The spinoff and termination must occur on or before the Compliance Date. Plan assets must be distributed as soon as administratively feasible after the plan termination date

(5) *CO Decision and Implementation.* The CO must provide notice of the selected option to the PEO by a date specified by the PEO. If a CO fails to timely inform the PEO of the option it selected, the PEO must treat the CO as having selected option 5.03(4)(c) (Spinoff of assets and liabilities). The PEO must implement the choice made or deemed made by each CO on or before the Compliance Date.

(6) *Determination Letter request*. The PEO must request determination letters on the Multiple Employer Retirement Plan and the Spinoff Retirement Plan. See section 7.02 of this revenue procedure for further information on an application for a determination letter on the qualified status of a Multiple Employer Retirement Plan. See section 5.06 of this revenue procedure for further information on determination letters on plan terminations.

.04 *Transfers to CO's plan or Spinoff of CO's assets and liabilities.* This section

5.04 applies if the PEO decides to terminate the PEO Retirement Plan; if a CO chooses to terminate its participation in the PEO Retirement Plan and transfer its attributable assets and liabilities to the CO's plan; or if a CO's attributable assets and liabilities are spun off to a Spinoff Retirement Plan and distributed in connection with the termination of the Spinoff Retirement Plan.

(1) *Transfers to CO's plan.* (a) *Documentation of qualified status of plan maintained by the CO.* If a CO chooses to transfer its attributable assets and liabilities in a PEO's Retirement Plan to the CO's plan, the CO must provide the PEO, on or before a date specified by the PEO, with documentation that the plan to which assets are transferred is a qualified plan established and maintained by the CO. If such documentation is provided, the PEO must transfer the assets and liabilities attributable to the Worksite Employees from the PEO Retirement Plan to the CO's plan before the Compliance Date. If the CO fails to provide the PEO with this documentation, or any other information required by the PEO to effect transfer, on or before the date specified by the PEO, the PEO must utilize the procedures in section 5.04(2).

(b) *Qualified Plan Determination*. For purposes of determining whether a CO maintains a qualified plan, a "qualified plan" is a retirement plan that on or before the Compliance Date either (i) had received a favorable determination, notification, or opinion letter that considered GUST (GUST is an acronym for the Uruguay Round Agreements Act (GATT), the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the Small Business Job Protection Act of 1996 (SBJPA), the Taxpayer Relief Act of 1997 (TRA'97), the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA'98) and the Community Renewal Tax Relief Act of 2000) or (ii) had submitted a request to the Service for a determination letter that considers GUST.

(2) *Spinoff and termination.* If a CO chooses a spinoff, or fails to timely notify the PEO of its selection, the PEO must implement a spinoff of the assets and liabilities of the PEO's Retirement Plan that are attributable to the CO's Worksite Employees to a Spinoff Retirement Plan. The Spinoff Retirement Plan may receive and hold assets and liabilities attributable to Worksite Employees of all of the COs that selected the spinoff option or failed to timely notify the PEO of a selection. The PEO must then terminate the Spinoff Retirement Plan on or before the Compliance Date and distribute benefits to the Worksite Employees performing services for the COs as soon as administratively feasible after the termination date. For purposes of this revenue procedure, a spinoff means a spinoff of plan assets and liabilities attributable to the Worksite Employees performing services for the COs selecting the spinoff option (or failing to timely select an option) from the PEO Retirement Plan to a Spinoff Retirement Plan that satisfies the transfer requirements of § 414(*l*).

.05 *Methods of providing notice*. Any notice required to be provided under this revenue procedure may be sent by any method, including an electronic medium, that reasonably ensures that the intended recipient will receive timely and adequate notice. For purposes of this revenue procedure, notice sent by United States mail is considered sent as of the date of the United States postmark stamped on the cover in which the notice is mailed.

.06 *Plan terminations.* (1) *Request for determination letter on plan termination*.

In choosing any of the options relating to plan terminations, a PEO must request a determination letter on the plan termination. Section 12 of Rev. Proc. 2002-6, 2002-1 I.R.B. 203, explains the procedures for requesting determination letters involving qualification of a plan upon plan termination. The permanency requirement described in § 1.401-1(b)(2) will not be raised as a disqualifying defect for plans being terminated pursuant to this revenue procedure. The request for a determination letter must be made within one year of the date of termination using the applicable provisions of Rev. Proc. 2002-6.

(2) *Distribution treated as being from a qualified plan*. Distributions made to Worksite Employees upon the termination of the PEO Retirement Plan or Spinoff Retirement Plan in accordance with this section will not fail to be eligible for favorable tax treatment accorded distributions from qualified plans (including eligibility for tax-free rollovers) solely because the plan violated the exclusive benefit rule of § 401(a)(2).

.07 *Example*. (i) A PEO maintains a PEO Retirement Plan established in 1994, and the PEO uses the calendar year for its plan year. The PEO Retirement Plan treats all Worksite Employees performing services for COs as employees of the PEO. There are 75 COs with Worksite Employees benefiting under the PEO Retirement Plan.

(ii) After reviewing the options set forth in section 5, the PEO decides to convert the PEO Retirement Plan to a Multiple Employer Retirement Plan. In accordance with the requirements of section 5.03, on January 31, 2003, the PEO adopts amendments to the PEO Retirement Plan converting the plan to a Multiple Employer Retirement Plan, effective January 1, 2004. On February 14, 2003, the PEO mails notification to each CO that it has decided to convert the PEO Retirement Plan to a Multiple Employer

Retirement Plan and explains the options available to the CO as described in section 5.03(4). In its letter to the COs, the PEO explains that each CO has until August 15, 2003, to notify the PEO, in writing, of its choice. The letter explains that if the CO does not notify the PEO of its selected option on or before August 15, 2003, the PEO will treat the CO as having selected the spinoff and termination option. The letter further explains that if a CO elects to adopt the Multiple Employer Retirement Plan, the Plan must be adopted on or before December 1, 2003.

(iii) By August 15, 2003, fifty of the COs with Worksite Employees benefitting under the PEO Retirement Plan notify the PEO of their decision to adopt and maintain the Multiple Employer Retirement Plan for the Worksite Employees. By December 1, 2003, forty-nine of the fifty COs adopted the Multiple Employer Retirement Plan, effective January 1, 2004. In accordance with section 5.03(4)(a) of this revenue procedure, on December 10, 2003, the PEO spins off the assets and liabilities attributable to the one CO that did not timely adopt the Multiple Employer Retirement Plan to a Spinoff Retirement Plan.

(iv) Ten COs timely elect a transfer, in which the assets and liabilities attributable to each CO's Worksite Employees are transferred to a qualified retirement plan established and maintained by each CO, and that satisfy the requirements described in section 5.04(1). The ten COs timely provide all information required to effect the transfer, including documentation of the plans' qualified status. The transfers to each of the CO plans are completed by December 31, 2003.

(v) Ten COs affirmatively elect the spinoff and termination option. The PEO spins off plan assets and liabilities attributable to the Worksite Employees performing services for those COs to the Spinoff Retirement Plan on December 10, 2003.

(vi) The remaining five COs failed to notify the PEO of their choice by August 15, 2003. Therefore, in accordance with requirements in section 5.03(5), each of those COs is treated as having selected the spinoff and termination option as its choice. The PEO spins off the assets and liabilities of these COs to the Spinoff Retirement Plan on December 10, 2003.

(vii) On December 11, 2003, the PEO terminates the Spinoff Retirement Plan. On February 5, 2004, the PEO submits an application for a determination letter on the termination of the Spinoff Retirement Plan. The PEO receives a favorable determination letter on the termination of the plan. As soon as administratively feasible following the termination, distributions are made to the Worksite Employees performing services for the sixteen COs (the one CO that failed to timely adopt the Multiple Employer Retirement Plan, the ten COs that selected the spinoff and termination option, and the five COs that failed to timely notify the PEO of their choice) with assets in the Spinoff Retirement Plan.

(viii) On February 5, 2004, the PEO submits an application for a determination letter on the qualified status of the Multiple Employer Retirement Plan, and subsequently receives such a determination letter from the Service. Because the PEO took all of the steps required in section 5 of the revenue procedure, the PEO Retirement Plan is entitled to the relief set forth in section 4 of the revenue procedure.

.08 *PEOs not electing to take advantage of relief under this revenue procedure.* If a PEO does not, as of the Compliance Date, either terminate the PEO Retirement Plan it maintains for Worksite Employees performing services for COs (as provided for in section 5.02) or convert the PEO Retirement Plan to a Multiple Employer Retirement Plan (as provided for in section 5.03), the relief in this revenue procedure is not available for any violations of the qualification requirements, including violations of the exclusive benefit rule, by PEO Retirement Plan.

.09 *No Reliance on Determination Letters for PEO Retirement Plans.* After the Compliance Date, a PEO may not rely on a determination letter for a PEO Retirement Plan that benefits Worksite Employees performing services for COs, regardless of when the determination letter was issued.

**SECTION 6. DEFINITIONS**

.01 *PEO Retirement Plan.* The term “PEO Retirement Plan” means a defined contribution plan (including a plan that includes a cash or deferred arrangement described in § 401(k)) intended to satisfy the requirements of § 401(a) or § 403(a). The definition of a PEO Retirement Plan does not include a plan maintained as a multiple employer plan that has been adopted by a PEO and one or more COs.

.02 *Multiple Employer Retirement Plan*. The term “Multiple Employer Retirement Plan” means a defined contribution plan (including a plan that includes a cash or deferred arrangement described in § 401(k)) intended to satisfy the requirements of § 401(a) or § 403(a), and § 413(c), under which each CO is treated as an employer.

.03 *Spinoff Retirement Plan.* The term “Spinoff Retirement Plan” means a separate plan established by a PEO for the specific purpose of a spinoff and termination as provided for in section 5.04(2).

.04 *Worksite Employees*. The term “Worksite Employees” means employees who receive amounts from a PEO for providing services to a CO pursuant to a service agreement between the PEO and the CO.

.05 *Client Organization*. The term “Client Organization” (CO) means an organization that enters into a service agreement with a PEO under which Worksite Employees provide services to the organization.

**SECTION 7. PROCEDURES AND TRANSITIONAL RULE**

.01 *Other qualification issues.* (1) *Use of EPCRS*. Plan qualification issues, other than the exclusive benefit issue for which relief is provided under this revenue procedure, may be resolved under the Employee Plans Compliance Resolution System (EPCRS). See Rev. Proc. 2001-17, 2001-7 I.R.B. 589.

(2) *Transitional relief for PEOs*. For purposes of determining whether a retirement plan maintained by a PEO for the benefit of Worksite Employees of COs satisfies the requirements of § 401(a)(2) prior to the Compliance Date, a PEO may treat Worksite Employees as its employees.

(3) *Transitional Rule for Code section 416.* For purposes of determining whether the Multiple Employer Retirement Plan is top heavy (as defined in § 416(g)(1)(A)(ii)) in its first plan year, the determination date with respect to the first plan year of such plan shall be the last day of such plan year. See § 416(g)(4)(C)(ii).

.02 *Determination letters*. (1) *Determination letter application*. Any application for a determination letter on the qualified status of any Multiple Employer Retirement

Plan adopted and maintained by PEOs and COs that are seeking relief under this revenue procedure shall be made under the relevant provisions of Rev. Proc. 2002-6.

(2) *Time of disqualification provision*. For purposes of § 1.401(b)-1(b) the Service will treat the requirement that the PEO adopt a Multiple Employer Retirement Plan by the Compliance Date as a disqualifying provision.

.03 *Pending examinations no bar to relief.* A PEO Retirement Plan under examination by the Service is eligible for the relief provided by this revenue procedure.

**SECTION 8. EFFECT ON OTHER DOCUMENTS**

Rev. Proc. 2002-6 is modified.

**SECTION 9. EFFECTIVE DATE**

This revenue procedure is effective on May 13, 2002.

**DRAFTING INFORMATION**

The principal author of this revenue procedure is Jeanne Royal Singley of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Employee Plans taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Ms. Singley may be reached at 1-202-283-9888 (not a toll-free number).

**May 25, 2012**

Robert J. Toth, Jr.
Law Offices of Robert J. Toth, Jr.
110 West Berry Street, Suite 1809
Fort Wayne, Indiana 46802

2012-04A
ERISA SEC.
3(2)

Dear Mr. Toth:

This is in response to your request for guidance regarding the applicability of Title I of the Employee Retirement Income Security Act of 1974 (ERISA) to a retirement savings program operated by 401(k) Advantage LLC (Advantage). Specifically, you ask whether the Department of Labor (Department) would view the Program as a single "employee pension benefit plan" within the meaning of ERISA section 3(2) where multiple unrelated employers adopt the Plan to provide retirement benefits to their employees.

The following summary is based on the materials and representations you provided in support of your request and should not be treated as factual findings by the Department. You represent that TAG Resources LLC (TAG), is a registered investment advisory firm based in Knoxville, Tennessee. Advantage is a limited purpose corporation formed to operate the 401(k) Advantage LLC 401(k) Plan. (Advantage Plan or Plan). The Plan is intended to be a single "multiple employer" 401(k) profit-sharing plan covering employees of Advantage as well as employees of other unrelated employers that adopt the Plan. The current participation agreement form describes each participating employer as acting "directly as an employer" and as a "co-sponsor" of the Advantage Plan. You indicate that there are currently over 500 unrelated employers participating in the Plan.

TAG is designated as the administrator, within the meaning of ERISA section 3(16), of the Plan. Advantage signs the Forms 5500 filed for the Plan as the "plan sponsor." You represent that Advantage is also the "named fiduciary" for the Advantage Plan, and "assumes the risk and liability associated with the trustee role and removes every adopting employer from the liability associated with that role." According to the Plan's 2010 Form 5500, the Plan had over 9,800 participants in the 2010 plan year and $63,000,000 in net assets.

You have provided us with copies of several similar participation agreements, what appears to be an Advantage Plan document covering current participating employers, and an updated Plan document drafted to permit inclusion into the Plan of various Bermudian employers. The terms for prospective participating Bermudian employers are similar to those for currently participating employers, but the investment alternatives and service provider arrangements differ. There are no variations in the operative documents for these two groups of employers that would affect our analysis. Some of the materials you provided indicate that professional employer organizations (PEOs)[1] may become participating "employers" of the Advantage Plan, and unions may become plan "sponsors." In the latter case the Plan will cover employees of any employer who is a party to the union's collective bargaining agreement which provides for participation in the Plan by employees of the employer.

Under the participation agreement, participating employers delegate to TAG the "full responsibility of Plan Administrator" which includes resolving beneficiary disputes, interpreting plan terms, completing audited financial statements, and appointing investment advisors and investment managers. Each participating employer represents that it has "independently exercised its fiduciary judgment in selecting this plan and, initially, the attendant offering of investment contracts and funds." The participating employer also acknowledges that it has ongoing fiduciary responsibility to periodically review the performance of TAG and is responsible for periodically determining whether to continue the arrangement. The participation agreement further provides that a participating employer's obligation to review its delegation of authority extends "only to the portion of the plan which covers its own employees." Participating employers acknowledge that, as the Plan Sponsor, Advantage retains complete authority with regard to the Plan document, including the right to amend or restate the Plan document from time to time. Advantage and TAG each retain the authority to terminate any employer's participation in the Advantage Plan, and participating employers are permitted to discontinue or revoke participation in the Plan at any time upon 60 days written notice. In the event an employer's participation in the Plan is discontinued, the assets, liabilities, contracts and other plan assets allocable to the participating employer's participation in the Plan will be "spun off pursuant to Code Section 414(l) and such spun off assets shall constitute a retirement plan of the Participating Employer with such Participating Employer becoming the sponsor and the individual who has signed [the participation agreement] on behalf of the Participating Employer becoming Trustee for this purpose."

The documents we reviewed indicate that information concerning plan fees payable to TAG, and other service providers for administrative and recordkeeping services is disclosed in an appendix to the participation agreement. The participation agreement provides that by signing the participation agreement, the participating employer "hereby approves such compensation." These fees are paid on a monthly basis and are deducted

[1] In general, for purposes of this letter we understand a PEO to be a firm that provides a service under which an employer can outsource HR and administrative tasks such as payroll, workers' compensation, and recruiting. The PEO relationship to the employers and employees is often described as co-employment or joint employment for purposes such as tax withholding and filing related paperwork as the "employer" under the PEO's own employer identification number. The client company continues to be the direct employer under common law principles.

directly from the assets of the Plan. We understand that this fee disclosure is not intended to be a complete disclosure for all expenses of the Plan and that TAG will "provide information related to fees and expenses to the Participating Employer and to Plan Participants in a manner as otherwise required by law of Plan Administrators." There is no information in your material on compensation payable from the Plan to Advantage LLC as Plan trustee and named fiduciary.

**Relevant Law, Analysis, and Conclusion**

The term "employee pension benefit plan" is defined in section 3(2) of Title I of ERISA to include: "[A]ny plan, fund, or program . . . established or maintained by an employer or employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund or program . . . provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond . . ."

The term "employee organization," defined in section 3(4) of ERISA, in pertinent part, includes "any labor union or any organization of any kind . . . in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning an employee benefit plan, or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose in whole or in part, of establishing such a plan."

Section 3(5) of ERISA provides that the term "employer" means "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity."

The term "plan sponsor" is defined in section 3(16) of ERISA as (i) the employer in the case of an employee benefit plan established or maintained by a single employer, (ii) the employee organization in the case of a plan established or maintained by an employee organization, or (iii) in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan.

Although the Advantage Plan appears to provide benefits described in ERISA section 3(2), to be an employee pension benefit plan, it must also be established or maintained by an employer, an employee organization, or both. The materials we reviewed give no indication that the Plan was established or is maintained by an employee organization within the meaning of section 3(4) of ERISA. Nothing in the documents we reviewed indicates that employees participate in Advantage (the named plan sponsor) or TAG (the plan administrator), nor do either of these entities constitute an "employees' beneficiary association" as that term is used in the second part of section 3(4). There is no evidence that membership or ownership of Advantage or TAG is conditioned on one's status as an employee. Accordingly, the Advantage Plan does not appear to be established by an employee organization within the meaning of section 3(4) of Title I of ERISA.

The documents describe Advantage as the sponsor of the Plan; however, it does not appear that Advantage is acting as an "employer" within the meaning of ERISA section 3(5). Although employees of Advantage will participate in the Plan, Advantage would not have a direct employment relationship with the vast majority of the participants covered by the Plan. As a result, Advantage would not be acting directly as the employer within the meaning of ERISA section 3(5) in establishing and maintaining the Plan.

Additionally, according to the materials we reviewed, it does not appear that Advantage or any other entity involved in the administration or operation of the Plan would be a bona fide employer association acting in the interest of the direct employers whose employees are covered by the Plan. In this regard, in the absence of regulations under ERISA section 3(5), the Department has taken the view, on the basis of the definitional provisions of ERISA as well as the overall statutory scheme, that, in the absence of the involvement of an employee organization, a single "multiple employer" plan (*i.e.*, a plan to which more than one employer contributes) may, nevertheless, exist where a cognizable group or association of employers, acting in the interest of its employer members, establishes a benefit program for the employees of member employers and exercises control of the amendment process, plan termination, and other similar functions on behalf of these members with respect to a trust established under the program. *See e.g.*, Advisory Opinions 2003-17A and 2001-04A. *See also* Advisory Opinion 96-25A (if an employer adopts for its employees a program of benefits sponsored by a group or association that does not itself constitute an "employer" or an "employee organization," such an adopting employer or employee organization may have established a separate, single-employer benefit plan covered by Title I of ERISA). As explained in these and other advisory opinions, relevant factors in determining whether a purported plan sponsor is a bona fide group or association of employers include the following: how members are solicited; who is entitled to participate and who actually participates in the association; the process by which the association was formed, the purposes for which it was formed, and what, if any, were the preexisting relationships of its members; the powers, rights, and privileges of employer members that exist by reason of their status as employers; and who actually controls and directs the activities and operations of the benefit program. The employers that participate in a benefit program must, either directly or indirectly, exercise control over the program, both in form and in substance, in order to act as a bona fide employer group or association with respect to the program. There is nothing in your submission to support a conclusion that a bona fide association or group of employers is sponsoring the Advantage Plan.

It has been the Department's consistent view that where several unrelated employers merely execute identically worded trust agreements or similar documents as a means to fund or provide benefits, in the absence of any genuine organizational relationship between the employers, no employer group or association exists for purposes of ERISA section 3(5). Based on our review of the information provided, there is no employment based common nexus or other genuine organizational relationship that is unrelated to the provision of benefits between Advantage or TAG and the employers of employees that benefit from the Plan, or among the different groups of employees that participate in the Plan.[2] Rather than acting in the interest of an employer with respect to the Plan, Advantage and TAG appear to be acting more as service providers to the plan, much like a third party administrator or investment advisor. As a result, in the Department's view, neither Advantage nor TAG would constitute an employer for purposes of section 3(5) of ERISA that is capable of sponsoring the plan as a single "multiple employer" plan.

This conclusion reflects the established judicial view that the person or group maintaining an "employee benefit plan" under ERISA must be tied to the employees or the contributing employers by genuine economic or representational interests unrelated to the provision of benefits. *See MDPhysicians & Associates, Inc. v. State Bd. Ins.*, 957 F.2d 178,185 (5th Cir.), *cert. denied*, 506 U.S. 861 (1992) ("the entity that maintains the plan and the individuals that benefit from the plan [must be] tied by a common economic or representation interest, unrelated to the provision of benefits." (quoting *Wisconsin Educ. Assoc. Ins. Trust v. Iowa State Bd.,* 804 F.2d 1059, 1063 (8th Cir. 1986)). These common employment-based interests distinguish an employee benefit plan from other entities that underwrite benefits or provide administrative services. The Department has long adhered to this interpretation of ERISA. *See, e.g.,* Advisory Opinion 94-07A (it is the "commonality of interest" among the individuals that benefit from the plan and the party that sponsors the plan that "forms the basis for sponsorship of an employee welfare benefit plan"); Advisory Opinion 80-42A ("plans established and maintained by insurance entrepreneurs for the purpose of marketing insurance products to employers and employees at large are not ERISA plans."). In your submission, you assert that there is no need for a bona fide employer group or association or for any person to be acting indirectly in the interest of the direct employers because each employer who enters into a participation agreement with TAG to provide benefits to its employees through the Advantage Plan will be acting as a Plan "co-sponsor," and "acting directly on its own behalf" in separately adopting a "multiple employer" defined contribution plan for its own employees. As described above, the mere execution of identically worded trust agreements or similar documents by unrelated employers as a means to fund or provide benefits for their employees, is not a sufficient basis for concluding that the employers

[2] We note that any relationship between Advantage LLC as "sponsor" of the Advantage Plan, and the employees of participating employers is even more attenuated to the extent that the Advantage Plan permits participation as "employers" by entities themselves not acting directly as employers of the covered employees, such as unions acting on behalf of employers with whom they have collective bargaining agreements or PEOs acting on behalf of their client employers.

have established or maintain a single plan for purposes of ERISA. *See, e.g.,* Advisory Opinion 2008-07A. Participation agreements that label the signatory employers as co-sponsors of a plan do not change this conclusion. Accordingly, it is the view of the Department that the Plan does not constitute a single "multiple employer" plan for purposes of ERISA, but rather is an arrangement under which each participating employer establishes and maintains a separate employee benefit plan for the benefit of its own employees.

In your submission, you urge that the Department's historical interpretation of "employer" under section 3(5) of ERISA regarding multiple employer welfare arrangements (MEWAs) should be restricted to welfare plans and that a less restrictive interpretation be applied to retirement plans. The Department is of the view, however, that the term "employer" should have the same meaning in this context whether applied to the term welfare plan or pension plan. *See Sullivan v. Stroop,* 496 U.S. 478, 484 (1990).

Importantly, we note that persons who operate the arrangement would be subject to the fiduciary provisions of Title I to the extent they have control over plan assets or have discretionary control over the administration or management of the participating employers' separate plans. They would also be subject to the prohibited transaction provisions in ERISA section 406 to the extent they are "parties in interest" within the meaning of ERISA section 3(14) either as service providers to the separate employer plans or otherwise. Similarly, each employer sponsor of a plan that participates in the arrangement will be subject to ERISA's fiduciary provisions. *See* FAB 2002-03 (in selecting a service provider, plan fiduciaries must, consistent with the requirements of section 404(a), act prudently and solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan).

The Department is not expressing any opinion in this letter on the application of section 413(c) of the Internal Revenue Code (Code) to the Advantage Plan. Code section 413(c) addresses the tax qualified status of certain pension "plans" that cover the employees of multiple employers. Section 413 of the Code, however, does not control whether an arrangement is an "employee benefit plan" under ERISA. *Cf. In re Sewell*, 180 F.3d 707, 711 (5th Cir. 1999) (there is no requirement under ERISA that to be a plan governed by ERISA, a plan must be tax-qualified). Contrary to your suggestion, section 210 of ERISA and the regulations implementing the minimum coverage and participation rules of Part 2 of ERISA do not dictate a different conclusion. While those regulations refer to section 413 of the Code at various points (*see, e.g.,* 29 CFR 2530.210(c)), they do not purport to make questions of ERISA coverage turn on section 413 of the Internal Revenue Code. To the contrary, as the Department's regulations make clear (*see* 29 CFR 2530.201-1), the determination of ERISA coverage is a multiple step process, and, in order for Part 2 of ERISA to apply, "[f]irst, the plan must be an employee benefit plan as defined under section 3(3) of the Act and § 2510.3-3. (*See also* the definitions of employee welfare benefit plan, section 3(1) of the Act and § 2510.3-1 and employee pension benefit plan, section 3(2) of the Act and § 2510.3-2)." This letter concerns only whether the Advantage Plan is an "employee benefit plan" under sections 3(2) and 3(3) of ERISA. For the reasons set forth above, in the Department's view, it is not.

Nothing in your submission suggested that TAG, Advantage and the employers participating in the Plan would be a controlled group or corporations, a group of trades or businesses under common control, or otherwise have any substantial common ownership, control or organizational connections. *See* Advisory Opinion 89-06A (Department would consider a member of a controlled group which establishes a benefit plan for its employees and/or the employees of other members of the controlled group to be an employer within the meaning of section 3(5) of ERISA); Advisory Opinion 95-29A (employee leasing company may act directly or indirectly in the interest of an employer in establishing and maintaining employee benefit plan). This letter also does not address the circumstance where an employee pension plan is maintained by more than one employer as a result of a corporate merger, acquisition or divestiture transaction or other circumstance that involves a substantial economic, business, or representational purpose unrelated to provision of benefits to the employees of separate employers.[3]

This letter constitutes an advisory opinion under ERISA Procedure 76-1, and is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions. This letter relates solely to the application of Title I of ERISA to the arrangement that is the subject of your request and is not determinative of any particular treatment under the Code or any other federal or state law.

Sincerely,

Susan Elizabeth Rees
Chief, Division of Coverage, Reporting and Disclosure
Office of Regulations and Interpretations

[3] A "substantial business purpose" test applies in the context of ERISA section 3(37) to address arrangements formed solely to obtain the benefits of being regulated as a multiemployer plan under ERISA. *See* 29 C.F.R. § 2510.3-37. The Department has also applied a "substantial business purpose" in evaluating whether a health benefit program should be treated as a single employer plan or as multiple employer welfare arrangement (MEWA) for purposes of section 3(40) of ERISA. *See* ERISA Information Letter, dated March 1, 2006, to Mike Kreidler, Washington State Insurance Commissioner (at www.dol.gov/ebsa/regs/ILs/il030106.html).

**THE BILLION DOLLAR TYPO**:
*What Plans Need To Know Now*
*About Scrivener's Errors under ERISA*

By: Sherrie Boutwell and Deborah Fabricant, Boutwell Fay LLP

December 2009

What happens when the drafter of an ERISA plan makes an innocent error (a "scrivener's error") that unintentionally increases benefits to plan participants by more than $1.6 billion? Should the employer be stuck paying benefits that were never intended and never expected? Is the plan's tax-qualified status at risk if the plan document is not followed as written?

Two recent federal court decisions highlight the tension between the need to protect plan participants and the potential unfairness of allowing participants to receive a windfall just because of an innocent mistake, as well as the difference between correction by retroactive plan amendment under EPCRS and reformation of a plan document by a court under ERISA.

**The Verizon Case: can a "typo" be corrected by a court under ERISA?**

Last month, an Illinois federal district court used ERISA's equitable relief provision to reform the language of a cash balance plan to correct a so-called "scrivener's error," Young v. Verizon's Bell Atlantic Cash Balance plan, No. 05 C 7314, (N.D. Ill., Nov. 2, 2009). If the ruling stands, it will save Verizon over $1.6 billion dollars. However, the decision is already on appeal so Verizon should not start counting its money yet. And, despite Verizon's apparent victory, just over a year ago, the same judge that allowed the reformation slammed Verizon's attempt to reform its plan on its own, rather than applying to a court to reform the document. Young v. Verizon's Bell Atlantic Cash Balance Plan, 575 F Supp.2d 892 (N.D. Ill. 2008).

The Verizon case arose when a participant claimed that Verizon had miscalculated her cash balance plan account benefit, by applying a transition factor only once, instead of twice, as called for by the plan document. Verizon agreed that the plan Document, read literally, provided her the higher benefit, but the plan administrator denied her claim and the plan committee affirmed the denial, reasoning that it was the plan sponsor's intent "to apply the factor just once" and that the second reference in the plan language was "a mistake." In short, the committee decided to reform the plan itself by interpreting the document to mean what was intended rather than what the document literally said. When the participant sued, the court initially ruled that the plan had abused its discretion in attempting to reform the plan without a court ruling. The judge said the committee could not disregard the plan's unambiguous double reference to the transition factor and that it should have "sought to reform the plan document in court… subject to de novo judicial review." Following that decision, the committee did exactly what the court had suggested – it sought an order from the same court, asking the same judge to reform the document.

After a full evidentiary trial earlier this year, Verizon ultimately convinced the court to reform the plan language. Based on plentiful, uncontested evidence, Verizon was able to show that the literal plan language was a "scrivener's error" and that Verizon intended to apply the factor only once. For example, Verizon was able to produce "clear and convincing" evidence to show that:

- all of the participant communications before the plan conversion clearly explained that the transition factor would be applied only once;

- the drafting history unequivocally showed that the factor was to be applied only once and that there had been a drafting error;
- the course of conduct showed that in fact, the factor had been applied only once to many account balance calculations for years; and
- no participant had ever relied on the language in the plan.

Because these facts clearly supported Verizon's position (the judge said the evidence was "clear and convincing" that there was a scrivener's error as to which the participants had notice and upon which they had not relied), Verizon got the relief it requested.

Is this case good precedent for other plans facing scrivener error issues? Time will tell but it may not be - it is rare for the facts showing a scrivener's error to be as "clear and convincing" as those in the Verizon case. In addition, the amount of money at stake (over 1.6 billion dollars), which the judge viewed as an unfair and unexpected windfall to participants, clearly justified the high cost of protracted litigation for all parties.

More importantly, even the judge acknowledged that his decision to reform the plan is at odds with the long established and respected ERISA "plan document rule" which requires that participants' benefits be determined pursuant to a written plan document. In this case, the judge was able to reform an otherwise "unreformable" ERISA plan because the Verizon evidence was unequivocal that no participant had actually relied on the plan document containing the scrivener's error. But, as explained above, the Verizon case has already been appealed. It may not survive as the Verizon ruling conflicts with other rulings in which courts that have refused to reform "scrivener's errors" in ERISA plans.

The Ninth Circuit, which governs plans in California, is one such court. It has refused to deviate from the plan document rule to reform a scrivener's error. See Cinelli v. Security Pacific Corporation, 61 F.2d 1437 (9th Cir. 1995). So unyielding is the 9th Circuit's support for "ERISA's strong preference for the written terms of the plan" (quoted by the judge in the Verizon case), it would not be surprising for the 9th Circuit to refuse reformation even if presented with facts as strong as the Verizon scenario.

The Verizon case did not address or discuss the tax implications of reformation, but another recent case addressed and rejected the effect of approval by the IRS of a retroactive amendment under EPCRS and in that case, the participants won.

**The Cross Case: can a "typo" be corrected by retroactive amendment under EPCRS?**

In another recent unpublished scrivener's error case, Cross v. Bragg, No. 07-1699 (4th Cir. July 24, 2009) (unpublished), a plan actuary mistakenly changed a formula for calculating benefits to a richer formula but the plan continued calculating and paying benefits under the old formula until the plan discovered the error six years later. The plan sponsor then applied under EPCRS for a compliance statement approving correction by retroactive amendment, which the Service granted. When the plan sponsor tried to "revise" the documents retroactively, the participants, who admittedly had not relied on the error, brought suit, and the Fourth Circuit rejected the attempted reformation and made short shrift of giving any deference to the IRS determination. The Court correctly noted that the IRS's decision about taxability had nothing to do with the "contractual rights of a plan beneficiary" and ruled that ERISA prohibited the attempted reduction in benefits. It is our understanding that the IRS is revisiting its policies regarding retroactive plan amendments under EPCRS based on the ruling in this case.

So what do plans need to know <u>now</u> about scrivener's errors?

1. <u>The Verizon case, while a big win for the plan sponsor, is not as helpful as it seems</u>. If it is not reversed on appeal, Verizon will likely be limited by other courts to its specific, plan favorable facts.
2. <u>The facts of the case (and the ability to prove them) are critical</u>. Whether to seek judicial reformation depends on the facts and the court where the case will be litigated. Self-reformation may not be an option in certain circuits no matter how good the facts are.
3. <u>Seeking reformation could result in liability</u>. If a plan brings an action to seek reformation and it is denied, the plan could be potentially liable for the participants' attorneys' fees. Participants might also be able bring a counterclaim asserting a breach of fiduciary duties (especially in cases where the facts or the law of that circuit are not favorable to the plan).
4. <u>EPCRS only protects the sponsor from tax liability</u>. Following the Verizon case, plans should use EPCRS only to protect against adverse tax consequences and consider seeking a court ruling to correct for ERISA purposes.
5. <u>Maintain insurance</u>. Plan fiduciaries and service providers should maintain errors and omission insurance that would cover a scrivener's error. And be aware that most such policies require notice to the insurer promptly upon discovery of facts that could lead to a claim, as well as a requirement that the insured not admit to liability (which can be an issue in an EPCRS filing).
6. <u>Consider adding a "scrivener's error" provision to the plan</u>. Discuss with counsel safeguards that might be able to be built into the drafting process and into the plan document itself.

**UNITED STATES COURT OF APPEALS**

**FOR THE SECOND CIRCUIT**

August Term, 2013

(Argued: April 9, 2014 Decided: June 10, 2014)

Docket No. 13-2021-cv

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EUCHNER-USA, INC., MICHAEL LADD,
EUCHNER-USA, INC. 401-K PLAN,

Plaintiffs-Appellants,

- v.-

HARTFORD CASUALTY INSURANCE COMPANY,

Defendant-Appellee.

- - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - -x

Before: KEARSE, JACOBS, and LYNCH, Circuit Judges.

Euchner-USA, its Chief Executive Officer Michael Ladd, and the Euchner-USA 401-k Plan appeal from a judgment of the Northern District of New York (McAvoy, J.), granting summary judgment in favor of Hartford Casualty

Insurance Company. Hartford denied coverage and refused to defend Euchner in a lawsuit alleging, *inter alia*, ERISA violations stemming from an alleged misclassification of a former employee as an independent contractor. For the following reasons, we conclude there was a reasonable possibility of coverage and, therefore, Hartford had a duty to defend. As a result, we vacate and remand in part. We affirm the dismissal of Euchner's claim brought under N.Y. Gen. Bus. Law § 349.

ALAN J. PIERCE, Hancock Estabrook, LLP, Syracuse, NY, for Plaintiffs-Appellants.

KENNETH R. LANGE (Brendan T. Fitzpatrick, on the brief), Goldberg Segalla LLP, Garden City, NY, for Defendant-Appellee.

DENNIS JACOBS, Circuit Judge:

This declaratory judgment action under New York law involves Hartford Casualty Insurance Company's issuance to Euchner-USA of comprehensive general liability insurance with an endorsement covering the company's employee benefits program. Hartford has denied coverage and refused a defense as to a suit in which the plaintiff alleged (a) that she was sexually harassed and

(b) that she was coerced into accepting a changed status that Euchner improperly classified as an independent sales position, with resulting loss of employee benefits under Euchner's 401(k) plan.

Euchner, its Chief Executive Officer ("CEO") Michael Ladd, and the Euchner 401-k Plan (collectively, "Euchner") appeal from a judgment of the Northern District of New York (McAvoy, J.), granting Hartford's motion for summary judgment on the ground that the underlying suit alleged only intentional wrongdoing. Having ruled that Hartford did not owe a defense, the court did not reach the issue of indemnity. For the following reasons, we conclude that a reasonable possibility existed that some claims in the former employee's (amended) complaint might implicate the coverage extended by endorsement, and that Hartford therefore owed a duty to defend. We do not reach the issue of indemnity. We therefore vacate and remand in part. The dismissal of the claim brought under N.Y. Gen. Bus. Law § 349 is affirmed.

**BACKGROUND**

In April 2011, Euchner was sued by former employee Jada Scali. Scali Compl., J.A. at 56-74. Her initial complaint alleged that she was hired as a regional sales manager in 2008, that she was sexually harassed by a senior executive, that she confronted him about his conduct, that she was wrongfully terminated as an employee, that she was coerced into accepting an independent sales position, and that the new position disqualified her from receiving a number of benefits reserved for the company's employees. Passim, the initial complaint characterized Euchner's conduct as "unlawful," "fraudulent," "discriminatory," and "wrongful coercion." Id.

Euchner forwarded the complaint to Hartford, which had issued a primary Commercial General Liability policy and an excess policy to Euchner. The policy forms excluded coverage for employment-related practices; but employee benefits liability was covered by an endorsement providing that Hartford would pay "those sums that the insured becomes legally obligated to pay as 'damages' because of 'employee benefits injury' to which this insurance applies." Emp. Benefits Liab. Coverage Form, J.A. at 46. "Employee benefits injury" was defined as an "injury that arises out of any negligent act, error or omission in the 'administration' of your 'employee benefits programs.'" Id. at 51. Coverage was excluded for civil or criminal liability arising out of "[a]ny dishonest, fraudulent, criminal or malicious act." Id. at 47.

In May 2011, Hartford disclaimed coverage for the Scali action, citing the exclusion for employment-related practices. Euchner does not contest this initial disclaimer and refusal to defend.

In October 2011, Scali filed an amended complaint. The factual allegations were substantially the same as those in the original complaint, but Scali added the Euchner 401-k Plan as a defendant and included causes of action under the Employee Retirement Income Security Act of 1974 ("ERISA"), Pub. L. No. 93-406, 88 Stat. 829. Scali Am. Compl., J.A. at 83, 101-04. The ERISA claims alleged that Euchner "improperly classified" Scali as an independent contractor rather than as an employee. Id. at 101-04. As a result of this misclassification, she was allegedly deprived of benefits under Euchner's 401(k) plan.

Euchner sent the amended complaint to the insurer, along with additional documents describing Scali's relationship with the firm. The amended complaint was reviewed by a litigation consultant at Hartford, who determined the newly-added ERISA claims triggered Hartford's coverage under the employee benefits liability endorsement. His supervisor disagreed, however, and Hartford disclaimed coverage and refused to mount a defense on two grounds: (1) the policy only covered employee claims, whereas Scali's Independent Sales

Management Agreement established that she had become an independent contractor; and (2) in any event, there was an exclusion for any liability arising out of a failure by Euchner to comply with regulatory reporting requirements associated with an employee benefits program.[1]

After this second disclaimer of coverage and refusal to undertake a defense, Euchner retained counsel to defend the Scali action and to continue coverage discussions with the Hartford. When Euchner later informed Hartford of an impending settlement of the Scali action, Hartford sent another disclaimer, this time relying on the exclusion for wrongful conduct. In April 2012, Euchner settled the Scali action for a confidential sum.

Euchner commenced this action to determine the rights and obligations of the parties under the insurance policy, and whether Hartford is required to reimburse Euchner for attorney's fees and a portion of the Scali settlement amount. Euchner also alleged Hartford's actions violated N.Y. Gen. Bus. Law § 349.

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[1] Hartford's letter quotes extensively from the policy language, including the exclusion for any "dishonest, fraudulent, criminal or malicious act." However, this exclusion did not form the basis of Hartford's disclaimer of coverage. Hartford Disclaimer Letter, dated Oct. 26, 2011, J.A. at 175-83.

After discovery, the parties cross-moved for summary judgment. The district court ruled that Hartford had no duty to defend because the policy excluded the intentional conduct alleged in Scali's amended complaint, and granted summary judgment in favor of Hartford. The court denied reconsideration in a Decision and Order dated July 8, 2013. See Euchner-USA, Inc. v. Hartford Cas. Ins. Co., No. 5:12-CV-604, 2013 WL 3455733 (N.D.N.Y. July 8, 2013). This appeal followed.

## DISCUSSION

We review a grant of summary judgment *de novo*. Guertin v. United States, 743 F.3d 382, 385 (2d Cir. 2014). "Summary judgment is proper 'if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.'" Id. (quoting Fed. R. Civ. P. 56(a)). "'In considering the evidence, the court must resolve all ambiguities, and credit all factual inferences that could rationally be drawn, in favor of the party opposing summary judgment even if contrary inferences might reasonably be drawn.'" Id. (quoting Natural Res. Def. Council, Inc. v. U.S. Food & Drug Admin., 710 F.3d 71, 79 (2d Cir. 2013)).

# I

The parties agree that New York law controls whether Hartford had a duty to defend the Scali action. In New York, an insurer's duty to defend is "exceedingly broad" and distinct from the duty to indemnify. Auto. Ins. Co. of Hartford v. Cook, 7 N.Y.3d 131, 137 (2006) (quotation marks omitted). "The duty to defend is measured against the allegations of pleadings but the duty to pay is determined by the actual basis for the insured's liability to a third person." Servidone Constr. Corp. v. Sec. Ins. Co. of Hartford, 64 N.Y.2d 419, 424 (1985). "The duty [to defend] remains 'even though facts outside the four corners of [the] pleadings indicate that the claim may be meritless or not covered.'" Auto. Ins. Co. of Hartford, 7 N.Y.3d at 137 (quoting Fitzpatrick v. Am. Honda Motor Co., 78 N.Y.2d 61, 63 (1991)) (second alteration in original). "Thus, an insurer may be required to defend under the contract even though it may not be required to pay once the litigation has run its course." Id.; see generally 1 Ostrager & Newman, Handbook on Insurance Coverage Disputes § 5.02 (16th ed. 2013).

"[A]n insurer will be called upon to provide a defense whenever the allegations of the complaint 'suggest . . . a reasonable possibility of coverage.'" Auto. Ins. Co. of Hartford, 7 N.Y.3d at 137 (quoting Cont'l Cas. Co. v. Rapid-

American Corp., 80 N.Y.2d 640, 648 (1993)) (ellipsis in original); see also Town of Massena v. Healthcare Underwriters Mut. Ins. Co., 98 N.Y.2d 435, 443 (2002) (stating the duty to defend arises whenever allegations in a complaint give rise to the "reasonable possibility of recovery under the policy" (quotation marks omitted)); Servidone, 64 N.Y.2d at 424 (stating duty to defend is distinguishable from the duty to indemnify because it is based on the mere possibility of coverage from the face of the complaint). "If, liberally construed, the claim is within the embrace of the policy, the insurer must come forward to defend its insured no matter how groundless, false or baseless the suit may be." Auto. Ins. Co. of Hartford, 7 N.Y.3d at 137 (quotation marks omitted). Whether a complaint asserts additional claims falling outside the policy is immaterial. See Town of Massena, 98 N.Y.2d 435 at 443-44. "Any doubt as to whether the allegations state a claim within the coverage of the policy must be resolved in favor of the insured and against the carrier." Brook Shopping Ctr. v. Liberty Mut. Ins. Co., 80 A.D.2d 292, 294 (N.Y. 1st Dep't 1981) (citation omitted).

Hartford's policy covered "employee benefits injury," defined as an "injury that arises out of any negligent act, error or omission in the 'administration' of [Euchner's] 'employee benefits programs.'" Emp. Benefits

Liab. Coverage Form, J.A. at 46, 51. The operative allegations of Scali's amended complaint are that Euchner misclassified her as an independent contractor rather than an employee, thus depriving her of pension benefits under the 401(k) plan. The parties do not dispute that the 401(k) plan is an "employee benefits program" under the policy. The decisive issue is whether there was a reasonable possibility that Scali's ERISA claims arose (A) from negligence in (B) administering the 401(k) plan.

**A**

Scali's ERISA claims raised a reasonable possibility of negligence on Euchner's part. It was alleged only that Euchner misclassified her position; it was not alleged whether this misclassification was done intentionally or negligently. The complaint contained allegations that bespeak malice; but none of Scali's ERISA claims alleged that Euchner improperly classified her with the *purpose* of interfering with her retirement benefits. Nowhere in the amended complaint, for example, did Scali allege that Euchner violated ERISA Section 510, 29 U.S.C. § 1140 (protecting against an employer's discharge of an employee "for the purpose of interfering with the attainment of any right to which such participant may become entitled under" an ERISA plan). Nor did Scali's ERISA claims require a showing of intent; they stood or fell on whether, notwithstanding the classification as an independent contractor, Euchner so controlled Scali's activities that she came within the common-law definition of an employee. See Nationwide Mut. Ins. Co. v. Mortensen, 606 F.3d 22, 31 (2d Cir. 2010).

Hartford emphasizes that its policy contained an exclusion for wrongful, unlawful, intentional, or fraudulent conduct. "When an exclusion clause is relied upon to deny coverage, the burden rests upon the insurance company to demonstrate that the allegations of the complaint can be interpreted *only* to exclude coverage." Town of Massena, 98 N.Y.2d at 444 (emphasis added). "When an insurer seeks to disclaim coverage on the [] basis of an exclusion . . . the insurer will be required to provide a defense unless it can demonstrate that the allegations of the complaint cast that pleading solely and entirely within the policy exclusions, and, further, that the allegations, *in toto*, are subject to no other interpretation." Auto. Ins. Co. of Hartford, 7 N.Y.3d at 137 (quotation marks omitted). "[E]xclusions are subject to strict construction and must be read narrowly." Id. (citation omitted)

The amended complaint alleged that Euchner "unlawfully and with discriminatory intent terminated Plaintiff as an employee and fraudulently, unwillingly and wrongfully coerced Plaintiff into entering into an Independent Sales Manager Representative Agreement." Scali Am. Compl., J.A. at 87-88. But as to the ERISA classification, it was alleged only that it was done "improperly and unlawfully," id., which is a legal conclusion, not an allegation of fact. And as Hartford observes, the focus should be on the complaint's factual allegations rather than its legal assertions. See Bridge Metal Indus., L.L.C. v. Travelers Indem. Co., 812 F. Supp. 2d 527, 537 n.8 (S.D.N.Y. 2011) (citing cases). "[T]he analysis depends on the facts which are pleaded, not the conclusory assertions." Allstate Ins. Co. v. Mugavero, 79 N.Y.2d 153, 162 (1992). Hartford therefore cannot show that the ERISA allegations fall entirely within this policy exclusion.

**B**

We further conclude that there is a reasonable possibility that the ERISA claims arose from the "administration" of Euchner's benefit plan. The Hartford policy defines "administration" as: 1) "[g]iving counsel to your employees or their dependents and beneficiaries, with respect to interpreting the scope of your 'employee benefits program' or their eligibility to participate in such programs"; and 2) "[h]andling records in connection with 'employee benefits program[s].'" Emp. Benefits Liab. Coverage Form, J.A. at 50.

We need not decide whether Euchner's classification of Scali as an independent contractor might be deemed advice or counsel to her regarding her eligibility, because it is clear enough that determining her eligibility may reasonably be considered part of the program's recordkeeping function.

Hartford's argument that "administration" encompasses only ministerial acts is unavailing. Hartford relies on Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Travelers Prop. Cas. Co., No. 05 Civ. 4648(NRB), 2006 WL 1489243, at *7 (S.D.N.Y. May 26, 2006), which held that "administration" in a similar context entailed "ministerial actions" rather than "deliberate, discretionary activity." Notwithstanding the National Union opinion and the cases it cites, no construction can modify the definition of the term in the contract wording. In any event, classification of someone either as an independent contractor or as an employee for purposes of program eligibility is not a matter of discretion.

In sum, there was a reasonable possibility of coverage under Hartford's policy as to Scali's ERISA claims. Hartford therefore had a duty to defend Euchner. On remand, the district court should consider Euchner's other arguments in the first instance, among other things: whether Hartford breached a duty to indemnify (a distinct question); and whether Euchner is entitled to attorney's fees in *this* action due to Hartford's breach of the duty to defend.

**II**

Euchner also challenges the dismissal of its claim under N.Y. Gen. Bus. Law § 349, which prohibits "[d]eceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state." A plaintiff bringing a § 349 claim must prove: 1) that the challenged act or practice was consumer-oriented; 2) that it was misleading in a material way; and 3) that the plaintiff suffered injury as a result of the deceptive act. See Stutman v. Chemical Bank, 95 N.Y.2d 24, 29 (2000); Small v. Lorillard Tobacco Co., 94 N.Y.2d 43, 55-56 (1999).

Typically, private contract disputes cannot form the basis of a § 349 claim. A plaintiff "must demonstrate that the acts or practices have a broader impact on consumers at large. Private contract disputes, unique to the parties, for example, would not fall within the ambit of the statute." Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank, N.A., 85 N.Y.2d 20, 25 (1995) (citation omitted); see also Zawahir v. Berkshire Life Ins. Co., 22 A.D.3d 841, 842 (N.Y. 2d Dep't 2005) ("This action simply involves a private contract dispute involving coverage under the subject policies, in contrast to the consumer-oriented, deceptive conduct aimed at the public at large that General Business Law § 349 is designed to address." (citation omitted)). Euchner has not shown that Hartford is engaged in a deceptive practice raising public, consumer-oriented concerns. Therefore, we affirm the district court's dismissal of Euchner's § 349 claim.

## CONCLUSION

For the foregoing reasons, we affirm in part, and vacate and remand in part.

U.S. Department of Labor
Wage and Hour Division
Washington, D.C. 20210

**Administrator's Interpretation No. 2016-1**

January 20, 2016

Issued by ADMINISTRATOR DAVID WEIL

SUBJECT: Joint employment under the Fair Labor Standards Act and Migrant and Seasonal Agricultural Worker Protection Act.

Through its enforcement efforts, the Department of Labor's Wage and Hour Division (WHD) regularly encounters situations where more than one business is involved in the work being performed and where workers may have two or more employers. More and more, businesses are varying organizational and staffing models by, for instance, sharing employees or using third-party management companies, independent contractors, staffing agencies, or labor providers. As a result, the traditional employment relationship of one employer employing one employee is less prevalent.[1] WHD encounters these employment scenarios in all industries, including the construction, agricultural, janitorial, warehouse and logistics, staffing, and hospitality industries.

The growing variety and number of business models and labor arrangements have made joint employment more common.[2] In view of these evolving employment scenarios, the Administrator believes that additional guidance will be helpful concerning joint employment

[1] For example, a corporate hotel chain may contract out to another business the management, catering, or housekeeping services at one of its hotels. Workers who perform these services at the hotel may wear uniforms with the name of the hotel chain or the other business and may perform tasks dictated by the hotel chain, the other business, or both.

[2] WHD considers joint employment in hundreds of investigations every year. WHD has determined, for example, that maritime fabrication facilities jointly employed welders, pipefitters, and other workers hired by staffing agencies; that hotels and hotel operating companies jointly employed housekeeping and guest services workers hired by staffing agencies; and that growers and farm labor contractors jointly employed farmworkers. *See also Perez v. Lantern Light Corp.*, 2015 WL 3451268, at *17 (W.D. Wash. May 29, 2015) (finding that satellite television provider was a joint employer of the installers employed by the company with whom the provider contracted to install its services).

under the Fair Labor Standards Act (FLSA), 29 U.S.C. 201, *et seq.*, and the Migrant and Seasonal Agricultural Worker Protection Act (MSPA), 29 U.S.C. 1801, *et seq.*[3]

Whether an employee has more than one employer is important in determining employees' rights and employers' obligations under the FLSA and MSPA. It is a longstanding principle under both statutes that an employee can have two or more employers for the work that he or she is performing. When two or more employers jointly employ an employee, the employee's hours worked for all of the joint employers during the workweek are aggregated and considered as one employment, including for purposes of calculating whether overtime pay is due. Additionally, when joint employment exists, all of the joint employers are jointly and severally liable for compliance with the FLSA and MSPA.[4] Where joint employment exists, one employer may also be larger and more established, with a greater ability to implement policy or systemic changes to ensure compliance. Thus, WHD may consider joint employment to achieve statutory coverage, financial recovery, and future compliance, and to hold all responsible parties accountable for their legal obligations.

Certainly, not every subcontractor, farm labor contractor, or other labor provider relationship will result in joint employment. This Administrator's Interpretation (AI) provides guidance on identifying those scenarios in which two or more employers jointly employ an employee and are thus jointly liable for compliance under the FLSA or MSPA. This AI first discusses the broad scope of the employment relationship under the FLSA and MSPA.[5] It then discusses the concepts of horizontal and vertical joint employment and relevant joint employment regulations.

Horizontal joint employment exists where the employee has employment relationships with two or more employers and the employers are sufficiently associated or related with respect to the

[3] In June 2014, WHD issued Administrator's Interpretation No. 2014-2, "Joint Employment of Home Care Workers in Consumer-Directed, Medicaid-Funded Programs by Public Entities under the Fair Labor Standards Act" (Home Care AI), available at http://www.dol.gov/whd/opinion/adminIntrprtn/FLSA/2014/FLSAAI2014_2.pdf. Although the Home Care AI was directed toward a particular employment scenario in a specific industry, the legal analyses in the Home Care AI and this Administrator's Interpretation are harmonious and are intended to be read in conjunction with one another.

[4] In other words, each joint employer is individually responsible, for example, for the entire amount of wages due. If one employer cannot pay the wages because of bankruptcy or other reasons, then the other employer must pay the entire amount of wages; the law does not assign a proportional amount to each employer.

[5] In July 2015, WHD issued Administrator's Interpretation No. 2015-1, "The Application of the Fair Labor Standards Act's 'Suffer or Permit' Standard in the Identification of Employees Who Are Misclassified as Independent Contractors" (Misclassification AI), available at http://www.dol.gov/whd/workers/Misclassification/AI-2015_1.pdf. In the Misclassification AI, the Administrator also discussed the FLSA's broad statutory definitions; that AI addressed the issue of the misclassification of employees as independent contractors and provided guidance regarding determining whether a worker is an employee or independent contractor.

~~e~~mployee such that they jointly employ the employee. The analysis focuses on the relationship of the employers to each other. This AI explains that guidance provided in the FLSA joint employment regulation – which focuses on the relationship between potential joint employers – is useful when analyzing potential horizontal joint employment cases.

Vertical joint employment exists where the employee has an employment relationship with one employer (typically a staffing agency, subcontractor, labor provider, or other intermediary employer) and the economic realities show that he or she is economically dependent on, and thus employed by, another entity involved in the work. This other employer, who typically contracts with the intermediary employer to receive the benefit of the employee's labor, would be the potential joint employer. Where there is potential vertical joint employment, the analysis focuses on the economic realities of the working relationship between the employee and the potential joint employer. This AI explains that guidance provided in the MSPA joint employment regulation is useful when analyzing potential vertical joint employment. The structure and nature of the relationship(s) at issue in the case, reflecting potentially horizontal or vertical joint employment or both, should determine how each case is analyzed.

## I. The FLSA and MSPA Broadly Define the Employment Relationship and Thus the Scope of Joint Employment

The scope of employment relationships subject to the protections of the FLSA and MSPA is broad. The FLSA defines "employee" as "any individual employed by an employer," 29 U.S.C. 203(e)(1), and "employer" as including "any person acting directly or indirectly in the interest of an employer in relation to an employee," 29 U.S.C. 203(d). The FLSA's definition of "employ" "includes to suffer or permit to work." 29 U.S.C. 203(g). The "suffer or permit" definition of employment is "'the broadest definition that has ever been included in any one act.'" *U.S. v. Rosenwasser*, 323 U.S. 360, 363 n.3 (1945) (quoting statement of Sen. Hugo Black, 81 Cong. Rec. 7657 (1938)). MSPA defines "employ" in exactly the same way as the FLSA, and the scope of employment relationships under MSPA is thus the same as it is under the FLSA. *See* 29 U.S.C. 1802(5) ("The term 'employ' has the meaning given such term under [the FLSA, 29 U.S.C. 203(g)]."); 29 C.F.R. 500.20(h)(1); *see also* 29 C.F.R. 500.20(h)(2)-(3) (the terms "employer" and "employee" under MSPA are also given their meaning as found in the FLSA).

The FLSA and MSPA both "specifically cover 'joint employment' relationships." *Antenor v. D & S Farms*, 88 F.3d 925, 929 (11th Cir. 1996). The FLSA regulations explicitly state that a single worker may be "an employee to two or more employers at the same time." 29 C.F.R. 791.2(a); *see also Baystate Alt. Staffing, Inc. v. Herman*, 163 F.3d 668, 675 (1st Cir. 1998) ("The FLSA contemplates several simultaneous employers, each responsible for compliance with the Act."). The MSPA regulations provide that MSPA's definition of the term "employ" includes the FLSA's joint employment principles. *See* 29 C.F.R. 500.20(h)(5); *see also Antenor*, 88 F.3d at 929 (MSPA makes clear that a worker can be jointly employed by more than one entity at the same time). "Joint employment under the Fair Labor Standards Act is joint employment under the MSPA." 29 C.F.R. 500.20(h)(5)(i) (emphasis omitted).[6]

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[6] The Department amended the MSPA joint employment regulation in 1997.

The concept of joint employment, like employment generally, "should be defined expansively" under the FLSA and MSPA. *Torres-Lopez v. May*, 111 F.3d 633, 639 (9th Cir. 1997); *see also* Misclassification AI, 3-4. The concepts of employment and joint employment under the FLSA and MSPA are notably broader than the common law concepts of employment and joint employment, which look to the amount of control that an employer exercises over an employee. *See Antenor*, 88 F.3d at 933. Unlike the common law control test, which analyzes whether a worker is an employee based on the employer's control over the worker and not the broader economic realities of the working relationship, the "suffer or permit" standard broadens the scope of employment relationships covered by the FLSA. *See Walling v. Portland Terminal Co.*, 330 U.S. 148, 150-51 (1947) (FLSA's definitions are "comprehensive enough to require its application" to many working relationships which, under the common law control standard, may not be employer-employee relationships); *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992) (FLSA's "suffer or permit" standard for employment "stretches the meaning of 'employee' to cover some parties who might not qualify as such under a strict application of traditional agency law principles."). The test for joint employment under the FLSA and MSPA is thus different, for example, than the test under other labor statutes, such as the National Labor Relations Act, 29 U.S.C. 151 *et seq*., and the Occupational Safety and Health Act, 29 U.S.C. 651 *et seq*. Indeed, in FLSA and MSPA cases, "courts have found economic dependence under a multitude of circumstances where the alleged employer exercised little or no control or supervision over the putative employees." *Antenor*, 88 F.3d at 933 n.10.

Moreover, prior to the FLSA's enactment, "suffer or permit" or similar phrasing was commonly used in state laws regulating child labor and was "designed to reach businesses that used middlemen to illegally hire and supervise children." *Antenor*, 88 F.3d at 929 n.5. A key rationale underlying the "suffer or permit" standard was that an employer should be liable for the child labor if it had the opportunity to detect work being performed illegally and the ability to prevent it from occurring. *See, e.g., People ex rel. Price v. Sheffield Farms-Slawson-Decker Co.*, 225 N.Y. 25, 29-31 (N.Y. 1918). Thus, the "suffer or permit to work" standard was designed to expand child labor laws' coverage beyond those who controlled the child laborer, counter an employer's argument that it was unaware that children were working, and prevent employers from using "middlemen" to evade the laws' requirements.

In sum, the expansive definition of "employ" as including "to suffer or permit to work" rejected the common law control standard and ensures that the scope of employment relationships and joint employment under the FLSA and MSPA is as broad as possible.

## II. Horizontal and Vertical Joint Employment Analyses in FLSA and MSPA Cases

The FLSA and MSPA regulations provide relevant and complementary guidance on joint employment. The structure and nature of the relationship(s) at issue should determine whether a particular case should be analyzed under horizontal or vertical joint employment, or both.[7]

[7] Given the potential complexity of employment relationships, aspects of both horizontal and vertical joint employment may be present in a single joint employment relationship. For example, both forms of joint employment could potentially exist where two warehouses share employees and use a staffing agency to provide them with labor.

Joint employment may exist when two (or more) employers each separately employ an employee and are sufficiently associated with or related to each other with respect to the employee. *See* 29 C.F.R. 791.2. This type of joint employment is sometimes referred to as horizontal joint employment. In a possible horizontal joint employment situation, there is typically an established or admitted employment relationship between the employee and each of the employers, and often the employee performs separate work or works separate hours for each employer. Thus, the focus of a horizontal joint employment analysis is the relationship between the two (or more) employers. The FLSA regulation provides guidance on horizontal joint employment. *See, e.g., Chao v. A-One Med. Servs., Inc.*, 346 F.3d 908, 917-18 (9th Cir. 2003) (citing FLSA regulation). Examples of horizontal joint employment may include separate restaurants that share economic ties and have the same managers controlling both restaurants, *see Chao v. Barbeque Ventures, LLC*, 2007 WL 5971772, at *6 (D. Neb. Dec. 12, 2007), or home health care providers that share staff and have common management, *see A-One Med. Servs.*, 346 F.3d at 918.

Joint employment may additionally exist when an employee of one employer (referred to in this AI as an "intermediary employer") is also, with regard to the work performed for the intermediary employer, economically dependent on another employer (referred to in this AI as a "potential joint employer").[8] *See* 29 C.F.R. 500.20(h)(5); *A-One Med. Servs.*, 346 F.3d at 917 (describing vertical joint employment as possible in circumstances where "a company has contracted for workers who are directly employed by an intermediary company"). This type of joint employment is sometimes referred to as vertical joint employment. The vertical joint employment analysis is used to determine, for example, whether a construction worker who works for a subcontractor is also employed by the general contractor, or whether a farmworker who works for a farm labor contractor is also employed by the grower.[9] Unlike in horizontal joint employment cases, where the association between the potential joint employers is relevant, the vertical joint employment analysis instead examines the economic realities of the relationships between the construction worker and the general contractor, and between the farmworker and the grower, to determine whether the employees are economically dependent on those potential joint employers and are thus their employees. The MSPA regulation provides a set of factors to apply an economic realities analysis in vertical joint employment cases. Although they do not all apply the same factors, several Circuit Courts of Appeals have also adopted an economic realities analysis for evaluating vertical joint employment under the FLSA. Regardless of the exact factors, the FLSA and MSPA require application of the broader

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[8] Depending on the industry, the "intermediary employer" in a vertical joint employment relationship could be, for example, a staffing agency, farm labor contractor, subcontractor, or other labor provider, supplier, or broker, and the "potential joint employer" could be a parent corporation, farm owner, higher-tier contractor, or client of the staffing agency or labor provider, supplier, or broker.

[9] As discussed below, a threshold determination in those examples would be whether the subcontractor or farm labor contractor itself is an independent contractor or whether it has an employment relationship with the general contractor or grower.

economic realities analysis, not a common law control analysis, in determining vertical joint employment.

The joint employment approaches described in the FLSA and MSPA regulations interpret the same definition of employment. MSPA borrowed the FLSA's definition of the term "employ" "with the deliberate intent" of adopting the FLSA's joint employer doctrine "as the 'central foundation' of MSPA and 'the best means by which to insure that the purposes of this MSPA would be fulfilled.'" 29 C.F.R. 500.20(h)(5)(ii) (quoting MSPA's legislative history); *see also* 29 C.F.R. 500.20(h)(5)(i) ("Joint employment under the Fair Labor Standards Act is joint employment under the MSPA.") (emphasis omitted). Therefore, the FLSA regulation is useful when analyzing potential horizontal joint employment cases, whether arising under the FLSA or MSPA. Likewise, the factors identified in the MSPA regulation are useful when analyzing potential vertical joint employment cases, whether arising under MSPA or the FLSA.[10] This is not to say that the MSPA joint employment regulation itself applies in FLSA cases; however, the MSPA joint employment regulation and its economic realities factors are useful guidance in an FLSA case because of the shared definition of employment and the coextensive scope of joint employment between the FLSA and MSPA.[11] For the reasons explained above, including the common definitions, using the joint employment factors identified in the MSPA regulation in an FLSA case is consistent with both statutes and regulations. It is also consistent with WHD's prior guidance. *See* Home Care AI, 3 (economic realities factors identified in the MSPA regulation should be considered when determining joint employment under the FLSA, citing 29 C.F.R. 500.20(h)); May 11, 2001 WHD Opinion Letter (identifying MSPA regulation's economic realities factors as relevant factors when determining joint employment under the FLSA, citing 29 C.F.R. 500.20(h)) (available at 2001 WL 1558966). Many potential joint employment cases arising under the FLSA will involve vertical joint employment, and an economic realities analysis of the type described in the MSPA joint employment regulation should be applied in those cases.

A. Horizontal Joint Employment and the Association of Potential Joint Employers

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[10] Courts have long turned to an economic realities analysis in analyzing vertical joint employment under the FLSA. The MSPA regulation itself cites to FLSA cases in defining joint employment. *See, e.g.,* 29 C.F.R. 500.20(h)(5)(ii) (citing *Hodgson v. Griffin & Brand of McAllen, Inc.*, 471 F.2d 235, 237 (5th Cir. 1973)).

[11] In *Layton v. DHL Express (USA), Inc.*, 686 F.3d 1172, 1176-78 (11th Cir. 2012), the court applied an economic realities analysis primarily based on the pre-1997 version of the MSPA joint employment regulation and correctly recognized that "in considering a joint-employment relationship, we must not allow common-law concepts of employment to distract our focus from economic dependency." Yet, because the case arose under the FLSA, not MSPA, the court declined to use the factors in the current MSPA joint employment regulation despite the fact that the FLSA and MSPA define the scope of employment in the same way. *See id.* at 1177 ("Although [MSPA] defines joint employment by reference to the definition provided in the FLSA, that does not mean that the reverse holds true—that joint employment under the FLSA is invariably defined by [MSPA] regulations.").

Horizontal joint employment should be considered when an employee is employed by two (or more) technically separate but related or overlapping employers.[12] For example, the horizontal joint employment analysis would apply where a waitress works for two separate restaurants that are operated by the same entity and the question is whether the two restaurants are sufficiently associated with respect to the waitress such that they jointly employ the waitress; or where a farmworker picks produce at two separate orchards and the orchards have an arrangement to share farmworkers. In these scenarios, there would already be an established employment relationship between the waitress and each restaurant, and between the farmworker and each orchard. This joint employment analysis focuses on the relationship of the employers to each other.

In cases where joint employment is established, the employee's work for the joint employers during the workweek "is considered as one employment," and the joint employers are jointly and severally liable for compliance, including paying overtime compensation for all hours worked over 40 during the workweek. 29 C.F.R. 791.2(a).

**Example:**[13] Casey, a registered nurse, works at Springfield Nursing Home for 25 hours in one week and at Riverside Nursing Home for 25 hours during that same week. If Springfield and Riverside are joint employers, Casey's hours for the week are added together, and the employers are jointly and severally liable for paying Casey for 40 hours at her regular rate and for 10 hours at the overtime rate. Casey should receive 10 hours of overtime compensation in total (not 10 hours from each employer).

In determining whether a horizontal joint employment relationship exists, the focus should be on the relationship (and often the degree of association) between the two (or more) potential joint employers with respect to the employee and all of the relevant facts of the particular case. *See* 29 C.F.R. 791.2(a). According to 29 C.F.R. 791.2(b), "[w]here the employee performs work which simultaneously benefits two or more employers, or works for two or more employers at different times during the workweek, a joint employment relationship generally will be considered to exist" in situations such as: (1) arrangements between the employers to share or interchange the employee's services; (2) where one employer acts directly or indirectly in the

[12] Even where two establishments are sufficiently related that they are part of a single enterprise (as defined in 29 U.S.C. 203(r)(1)) for FLSA coverage purposes, a separate determination is necessary to determine whether the establishments are joint employers. *See* 29 C.F.R. 779.203; *A-One Med. Servs.*, 346 F.3d at 917 ("Whether two companies constitute a single enterprise for FLSA coverage and whether they are liable as joint employers . . . are technically separate issues."). As explained by the case law, although the two analyses may require similar fact-finding and have similar considerations, determining that an employer is part of an enterprise to ascertain coverage under the FLSA is different from determining that the employer is a joint employer that is liable for minimum wages and overtime. *See, e.g., Patel v. Wargo*, 803 F.2d 632, 635 (11th Cir. 1986).

[13] The addition or alteration of any of the facts in any of the examples in this AI could change the resulting analysis.

interest of another employer in relation to the employee; or (3) where the employers are associated "with respect to the employment of a particular employee and may be deemed to share control of the employee, directly or indirectly, by reason of the fact that one employer controls, is controlled by, or is under common control with the other employer." *Id.* at 791.2(b). In *Schultz v. Capital International Security, Inc.,* for example, the court looked to the FLSA regulation and concluded that security workers were jointly employed by a security firm and the individual that the workers were hired to protect because the two employers were associated with respect to the employment of the workers and shared common control over them. *See* 466 F.3d 298, 306 (4th Cir. 2006) ("the entire employment arrangement fits squarely within the third example of joint employment in the regulation"). Specifically, the court explained that the employers were both involved in the hiring of the workers, played some role in scheduling, discipline, and terminations, and shared responsibility for supplying the workers with equipment. *See id.*

The following facts may be relevant when analyzing the degree of association between, and sharing of control by, potential horizontal joint employers:

- who owns the potential joint employers (i.e., does one employer own part or all of the other or do they have any common owners);
- do the potential joint employers have any overlapping officers, directors, executives, or managers;
- do the potential joint employers share control over operations (e.g., hiring, firing, payroll, advertising, overhead costs);
- are the potential joint employers' operations inter-mingled (for example, is there one administrative operation for both employers, or does the same person schedule and pay the employees regardless of which employer they work for);
- does one potential joint employer supervise the work of the other;
- do the potential joint employers share supervisory authority for the employee;
- do the potential joint employers treat the employees as a pool of employees available to both of them;
- do the potential joint employers share clients or customers; and
- are there any agreements between the potential joint employers.

*See, e.g.,* 29 C.F.R. 791.2(b); June 14, 2005 WHD Opinion Letter (identifying a number of the above facts as relevant in finding joint employment) (available at 2005 WL 6219105); April 11, 2005 WHD Opinion Letter (identifying a number of the above facts in finding joint employment) (available at 2005 WL 2086804); *Barbeque Ventures*, 2007 WL 5971772, at *1, 5-6 (separate legal entities who employed employees at five different restaurants were joint employers given common ownership, management and control; the same manager owned one legal entity, was the majority owner and manager of the other entity, and supervised the Area Director for all five restaurants). This is not an all-inclusive list of facts that could potentially be relevant to the analysis. Moreover, not all or most of the foregoing facts need to be present for joint employment to exist. Rather, these facts can help determine if there is sufficient indication that the potential joint employers are associated with respect to the employee and thus share control of the employee.

Joint employment does not exist, however, if the employers "are acting entirely independently of each other and are completely disassociated" with respect to an employee who works for both of them. 29 C.F.R. 791.2(a). In that event, each employer may disregard all work performed by the employee for the other when determining its own responsibilities under the law. *See id*. There are many workers who have multiple jobs with multiple employers who are not joint employers. For example, a high school teacher may also work a part-time job as an instructor for a standardized test preparatory company; the high school and the preparatory company would not be joint employers. In sum, the focus of the horizontal joint employment analysis is the degree of association between the two potential joint employers even if they are formally separate legal entities and the degree to which they share control of the employee.

**Example:** An employee is employed at two locations of the same restaurant brand. The two locations are operated by separate legal entities (Employers A and B). The same individual is the majority owner of both Employer A and Employer B. The managers at each restaurant share the employee between the locations and jointly coordinate the scheduling of the employee's hours. The two employers use the same payroll processor to pay the employee, and they share supervisory authority over the employee. These facts are indicative of joint employment between *Employers A and B.*

In contrast, an employee works at one restaurant (Employer A) in the mornings and at a different restaurant (Employer B) in the afternoons. The owners and managers of each restaurant know that the employee works at both establishments. The establishments do not have an arrangement to share employees or operations, and do not otherwise have any common management or ownership. These facts are not indicative of joint employment between *Employers A and B.*

B. Vertical Joint Employment and Economic Dependence on the Potential Joint Employer

The vertical joint employment inquiry focuses on whether the employee of the intermediary employer is also employed by another employer – the potential joint employer. In vertical joint employment situations, the other employer typically has contracted or arranged with the intermediary employer to provide it with labor and/or perform for it some employer functions, such as hiring and payroll. There is typically an established or admitted employment relationship between the employee and the intermediary employer. That employee's work, however, is typically also for the benefit of the other employer.

In contrast to the horizontal joint employment analysis, where the focus is the relationship between the employers, the focus in vertical joint employment cases is the employee's relationship with the potential joint employer and whether that employer jointly employs the employee. Examples of situations where vertical joint employment might arise include garment workers who are directly employed by a contractor who contracted with the garment manufacturer to perform a specific function, *see Zheng v. Liberty Apparel Co.*, 355 F.3d 61, 71-72 (2d Cir. 2003); nurses placed at a hospital by staffing agencies, *see Barfield v. N.Y. City Health & Hosps. Corp.*, 537 F.3d 132, 143-49 (2d Cir. 2008); or warehouse workers whose labor is arranged and overseen by layers of intermediaries between the workers and the owner or operator of the warehouse facility, *see Carrillo v. Schneider Logistics Trans-Loading & Distrib., Inc.*, 2014 WL 183956, at *9-15 (C.D. Cal. Jan. 14, 2014). *See also A-One Med. Servs.*, 346 F.3d at 917; *Lantern Light*, 2015 WL 3451268, at *3 (where company has contracted for workers who are directly employed by an intermediary, court applies vertical joint employment analysis to relationship between company and workers); *Berrocal v. Moody Petrol., Inc.*, 2010 WL 1372410, at *11 n.16 (S.D. Fla. Mar. 31, 2010) (vertical joint employment may exist when "an employer hires laborers through a third party labor contractor").

A threshold question in a vertical joint employment case is whether the intermediary employer (who may simply be an individual responsible for providing labor) is actually an *employee* of the potential joint employer. Where there is vertical joint employment, there is likely a contract or other arrangement – but not necessarily an employment relationship – between the intermediary employer and the potential joint employer.[14] If the intermediary employer is an employee of the potential joint employer, then all of the intermediary employer's employees are employees of the potential joint employer too, and there is no need to conduct a vertical joint employment analysis. For example, if a farm labor contractor is not actually an independent contractor but is an employee of the grower (i.e., is economically dependent on the grower as a matter of economic reality), then all of the farm labor contractor's farmworkers are also employees of the grower. *See* 29 C.F.R. 500.20(h)(4). Likewise, if a drywall subcontractor is not actually an independent contractor but is an employee of the higher-tier contractor, then all of the drywall subcontractor's workers are also employees of the higher-tier subcontractor. In sum, it is critical to first determine whether the intermediary employer is an employee of the potential joint employer before proceeding with the vertical joint employment analysis.[15]

Once it is determined that the intermediary is not an employee, the vertical joint employment analysis should be applied to determine whether the intermediary employer's employees are also employed by the potential joint employer. Because it is an employment relationship analysis under the FLSA or MSPA, the vertical joint employment analysis must be an economic realities analysis and cannot focus only on control. As WHD has explained, the Supreme Court and the Circuit Courts of Appeals apply an economic realities analysis to determine the existence of an employment relationship under the FLSA and MSPA. *See, e.g.*, Home Care AI; Misclassification AI; *Tony & Susan Alamo Found. v. Sec'y of Labor*, 471 U.S. 290, 301 (1985) (the test of employment under the FLSA is economic reality); *Goldberg v. Whitaker House Co-op, Inc.*, 366 U.S. 28, 33 (1961) (the economic realities of the worker's relationship with the employer are the test of employment); 29 C.F.R. 500.20(h)(5)(iii). The particular economic

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[14] The contract between the potential joint employer and the intermediary employer may purport to disclaim or deny any responsibility by the potential joint employer as an employer. However, that type of contractual provision is not relevant to the economic realities of the working relationship between the potential joint employer and the employee.

[15] The intermediary employer will be either an independent contractor or employee of the potential joint employer under the FLSA or MSPA. The Misclassification AI discusses the analysis for determining whether a worker is an employee or independent contractor. *See also* 29 C.F.R. 500.20(h)(4).

realities factors relied upon differ somewhat depending on the court, and courts routinely note that other additional relevant factors may be considered, but regardless, it is not a control test.

The MSPA regulation, describing seven economic realities factors in the context of a farm labor contractor acting as an intermediary employer for a grower, provides useful guidance to analyze any vertical joint employment case. *See* 29 C.F.R. 500.20(h)(5)(iv). These factors are probative of the core question of whether the employee is economically dependent on the potential joint employer who, via an arrangement with the intermediary employer, is benefitting from the work. As courts have cautioned, the factors in an economic realities analysis should not be considered mechanically or in a vacuum; rather, they are guides for resolving the ultimate inquiry whether the employee is economically dependent on the potential joint employer. *See Antenor*, 88 F.3d at 932-33; Misclassification AI, 5-6.[16] Accordingly, these factors should be applied in a manner that does not lose sight of that ultimate inquiry or the expansive definition of employment under the FLSA and MSPA. *See Antenor*, 88 F.3d at 932-33 ("the factors are used because they are indicators of economic dependence" and should be viewed "qualitatively to assess the evidence of economic dependence"). The seven factors are:

A. Directing, Controlling, or Supervising the Work Performed. To the extent that the work performed by the employee is controlled or supervised by the potential joint employer beyond a reasonable degree of contract performance oversight, such control suggests that the employee is economically dependent on the potential joint employer. The potential joint employer's control can be indirect (for example, exercised through the intermediary employer) and still be sufficient to indicate economic dependence by the employee. *See Torres-Lopez*, 111 F.3d at 643 ("indirect control as well as direct control can demonstrate a joint employment relationship") (citing pre-1997 MSPA regulation); *Antenor*, 88 F.3d at 932, 934; 29 C.F.R. 500.20(h)(5)(iv). Additionally, the potential joint employer need not exercise more control than, or the same control as, the intermediary employer to exercise sufficient control to indicate economic dependence by the employee.[17]

[16] The vertical joint employment economic realities factors overlap some with the economic realities factors used to determine whether a worker is an employee or an independent contractor, as discussed in the Misclassification AI. However, the exact factors applicable when determining whether a worker is an employee or an independent contractor cannot apply in a vertical joint employment case because they focus on the possibility that the worker is in business for him or herself (and thus is an independent contractor). In a vertical joint employment case, the worker is not in business for him or herself, but is an employee of the intermediary employer, and may also be employed by the potential joint employer.

[17] This point holds true for the vertical joint employment analysis in general. It is not necessary for the employee to be more economically dependent on the potential joint employer than the intermediary employer for there to be joint employment. *See Antenor*, 88 F.3d at 932-33. The focus is the employee's relationship with the potential joint employer and not a comparison of that relationship with the employee's relationship with the intermediary employer. *See id*.

B. Controlling Employment Conditions. To the extent that the potential joint employer has the power to hire or fire the employee, modify employment conditions, or determine the rate or method of pay, such control indicates that the employee is economically dependent on the potential joint employer. Again, the potential joint employer may exercise such control indirectly and need not exclusively exercise such control for there to be an indication of joint employment.

C. Permanency and Duration of Relationship. An indefinite, permanent, full-time, or long-term relationship by the employee with the potential joint employer suggests economic dependence. This factor should be considered in the context of the particular industry at issue. For example, if the work in the industry is by its nature seasonal, intermittent, or part-time, such industry condition should be considered when analyzing the permanency and duration of the employee's relationship with the potential joint employer.

D. Repetitive and Rote Nature of Work. To the extent that the employee's work for the potential joint employer is repetitive and rote, is relatively unskilled, and/or requires little or no training, those facts indicate that the employee is economically dependent on the potential joint employer.

E. Integral to Business. If the employee's work is an integral part of the potential joint employer's business, that fact indicates that the employee is economically dependent on the potential joint employer. Whether the work is integral to the employer's business has long been a hallmark of determining whether an employment relationship exists as a matter of economic reality. *See, e.g., Rutherford Food Corp. v. McComb*, 331 U.S. 722, 729-30 (1947).

F. Work Performed on Premises. The employee's performance of the work on premises owned or controlled by the potential joint employer indicates that the employee is economically dependent on the potential joint employer. The potential joint employer's leasing as opposed to owning the premises where the work is performed is immaterial because the potential joint employer, as the lessee, controls the premises.

G. Performing Administrative Functions Commonly Performed by Employers. To the extent that the potential joint employer performs administrative functions for the employee, such as handling payroll, providing workers' compensation insurance, providing necessary facilities and safety equipment, housing, or transportation, or providing tools and materials required for the work, those facts indicate economic dependence by the employee on the potential joint employer.

*See* 29 C.F.R. 500.20(h)(5)(iv).

Courts have applied many of the above factors to vertical joint employment scenarios in FLSA cases, though they have not explicitly relied on the MSPA regulation. *See, e.g., Carrillo v. Schneider Logistics,* 2014 WL 183956, at *6 (applying Ninth Circuit's joint employment economic realities analysis). In *Carrillo*, for example, warehouse workers sued the companies that operated the distribution warehouses and the company that owned the warehouses. The owner of the warehouses argued that it was not a joint employer of the warehouse workers. In denying the owner's motion for summary judgment, the court noted that there was evidence of possible joint employment for the following reasons: the owner exercised control over the warehouse workers' employment conditions because it approved staffing levels at the warehouse, directed that employees be shifted to an alternative workweek schedule, closely monitored productivity levels, and established various operating metrics; the work was performed on premises owned or leased by the owner, who provided all of the equipment necessary to perform work at its warehouses; the work consisted primarily of conventional manual labor, requiring little skill; and the work was an integral part of the owner's corporate strategy. *See id.* at *9-15. As the court did in *Carrillo,* applying these or similar factors will help to determine whether the employee is economically dependent on the potential joint employer.

As noted, the economic realities factors to apply vary somewhat depending on the court, but any formulation must address the "ultimate inquiry" of economic dependence. In applying any other relevant factors, the broad scope of joint employment under the FLSA and MSPA must be recognized. For example, in analyzing joint employment, the Second Circuit applies six economic realities factors: (1) use of the potential joint employer's premises and equipment for the work; (2) whether the intermediary employer has a business that can or does shift from one potential joint employer to another; (3) whether the employee performs a discrete line-job that is integral to the potential joint employer's production process; (4) whether the potential joint employer could pass responsibility for the work from one intermediary to another without material changes for the employees; (5) the potential joint employer's supervision of the employee's work; and (6) whether the employee works exclusively or predominantly for the potential joint employer. *See Zheng*, 355 F.3d at 71-72.

The Ninth Circuit applies factors from different sources: *Bonnette v. Cal. Health & Welfare Agency*, 704 F.2d 1465, 1470 (9th Cir. 1983) (four factor test primarily assessing potential joint employer's control of employment conditions); the pre-1997 version of the MSPA joint employment regulation; and the eight economic realities factors set forth in *Torres-Lopez*, 111 F.3d at 640-41. *See, e.g.*, *Lantern Light*, 2015 WL 3451268, at *2-17 (applying both the *Bonnette* and *Torres-Lopez* factors and finding that satellite television provider was a joint employer of the installers employed by the company with whom the provider contracted to install its services); *Chao v. Westside Drywall, Inc.*, 709 F. Supp. 2d 1037, 1061-62 (D. Or. 2010) (applying both the *Bonnette* and *Torres-Lopez* factors). Thus, there are several formulations of the economic realities factors used to determine the employee's economic dependence on a potential joint employer that are consistent with the broad scope of employment under the FLSA.

Some courts, however, apply factors that address only or primarily the potential joint employer's control (power to hire and fire, supervision and control of conditions or work schedules, determination of rate and method of pay, and maintenance of employment records). *See, e.g., Baystate Alt. Staffing*, 163 F.3d at 675; *In re Enter. Rent-A-Car Wage & Hour Emp't Practices Litig.*, 683 F.3d 462, 468-69 (3d Cir. 2012). This approach is not consistent with the breadth of employment under the FLSA. "Measured against the expansive language of the FLSA," addressing only the potential joint employer's control "is unduly narrow" and "cannot be reconciled with the 'suffer or permit' language in the [FLSA], which necessarily reaches beyond traditional agency law." *Zheng*, 355 F.3d at 69. Indeed, the Second Circuit explained that, although satisfaction of the four "formal control" factors can be sufficient to establish joint employment, it has "never held 'that a positive finding on those four factors is *necessary* to establish an employment relationship.'" *Barfield*, 537 F.3d at 143 (quoting *Zheng*, 355 F.3d at 69) (emphasis in original); *see also Zheng*, 355 F.3d at 69 ("[T]he broad language of the FLSA, as interpreted by the Supreme Court in *Rutherford,* demands that a district court look beyond an entity's formal right to control the physical performance of another's work before declaring that the entity is not an employer under the FLSA."). As explained above, the FLSA rejected control as the standard for determining employment, and any vertical joint employment analysis must look at more than the potential joint employer's control over the employee.[18]

**Example:** A laborer is employed by ABC Drywall Company, which is an independent subcontractor on a construction project. ABC Drywall was engaged by the General Contractor to provide drywall labor for the project. ABC Drywall hired and pays the laborer. The General Contractor provides all of the training for the project. The General Contractor also provides the necessary equipment and materials, provides workers' compensation insurance, and is responsible for the health and safety of the laborer (and all of the workers on the project). The General Contractor reserves the right to remove the laborer from the project, controls the laborer's schedule, and provides assignments on site, and both ABC Drywall and the General Contractor supervise the laborer. The laborer has been continuously working on the General Contractor's construction projects, whether through ABC Drywall or another intermediary. *These facts are indicative of joint employment of the laborer by the General Contractor*.

**Example:** A worker is hired by a farm labor contractor (FLC) to pick produce on a Grower's farm. The FLC hired and pays the worker. The Grower dictates the timing of the harvest, which fields the worker should harvest, and the schedule each day. The work is unskilled, and any training is provided by the Grower. The Grower keeps track of the amount of produce that the worker picks per

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[18] *Enterprise Rent-A-Car* involved whether a parent company was a joint employer of its subsidiaries' employees. *See* 683 F.3d at 464. The Third Circuit acknowledged the breadth of employment under the FLSA and that indirect control can show joint employment, but it nonetheless ruled that joint employment in that case was determined by whether the parent exercised significant control. *See id.* at 467-68. The Third Circuit recognized that the control factors "*do not constitute an exhaustive list* of all potential relevant facts" and should not be blindly applied; rather, a joint employment determination must consider the employment situation in totality, including the economic realities of the working relationship. *Id.* at 469 (emphasis in original). The Third Circuit seemed to leave open the possibility that, in a case involving an intermediary employer providing labor to another employer, it would consider applying economic realities factors beyond the control factors applied in *Enterprise Rent-A-Car* to determine whether that other employer is a joint employer.

hour. The Grower provides the buckets for the produce, transports the produce from the field, and stores the produce. The Grower pays the FLC per bucket of produce picked, and withholds money to cover workers' compensation insurance. The worker has been continuously working on the Grower's farm during the harvest seasons, whether through this FLC or another farm labor contractor. *These facts are indicative of joint employment of the worker by the Grower.*

**Example:** A mechanic is employed by Airy AC & Heating Company. The Company has a short-term contract to test and, if necessary, replace the HVAC systems at Condor Condos. The Company hired and pays the mechanic and directs the work, including setting the mechanic's hours and timeline for completion of the project. For the duration of the project, the mechanic works at the Condos and checks in with the property manager there every morning, but the Company supervises his work. The Company provides the mechanic's benefits, including workers' compensation insurance. The Company also provides the mechanic with all the tools and materials needed to complete the project. The mechanic brings this equipment to the project site. *These facts are not indicative of joint employment of the mechanic by the Condos.*

## III. Conclusion

As a result of continual changes in the structure of workplaces, the possibility that a worker is jointly employed by two or more employers has become more common in recent years. In an effort to ensure that workers receive the protections to which they are entitled and that employers understand their legal obligations, the possibility of joint employment should be regularly considered in FLSA and MSPA cases, particularly where (1) the employee works for two employers who are associated or related in some way with respect to the employee; or (2) the employee's employer is an intermediary or otherwise provides labor to another employer.

Whether to apply a horizontal or vertical joint employment analysis (or both analyses) depends on the circumstances of the case. The focus of a horizontal joint employment analysis is the relationship and association between the two (or more) potential joint employers, and the FLSA joint employment regulation provides guidance in evaluating such cases. The focus of the vertical joint employment analysis is the relationship between the employee and the potential employer and whether an employment relationship exists between them. The analysis must determine whether, as a matter of economic reality, the employee is economically dependent on the potential joint employer. The economic realities factors in the MSPA regulation provide guidance for analyzing vertical joint employment cases, although additional or different economic realities factors that are consistent with the broad scope of employment under the FLSA and MSPA may be helpful as well.

WHD will continue to consider the possibility of joint employment to ensure that all responsible employers are aware of their obligations and to ensure compliance with the FLSA and MSPA. As with all aspects of the employment relationship under the FLSA and MSPA, the expansive definition of "employ" as including "to suffer or permit to work" must be considered when determining joint employment, so as to further the statutes' remedial purposes.