An Independent Contractor, an Employee, and Their Attorney Walk into a Bar: Why This Is No Joke for a Nonprofit

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Venable LLP, Washington, DC

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Upcoming Venable Nonprofit Events

More events coming this fall...
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<th>“So what”</th>
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<td>“What”</td>
<td>What distinguishes independent contractors from employees</td>
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<td>“How to get it right”</td>
<td>Documenting and implementing the independent contractor relationship</td>
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<td>“How to get it wrong”</td>
<td>What you can and cannot do to fix it</td>
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Why Is Misclassifying Independent Contractors No Joke for Nonprofits?

- Civil penalties and damages:
  - Overtime wages
  - Workers’ compensation penalties
  - Unemployment insurance violations
  - Payroll tax penalties
  - Benefit plan violations
  - I-9 violations
- Class action lawsuits
- Government audits
- Anti-discrimination lawsuits
Common Misclassification Problems for Nonprofits

• Over-reliance upon representations within independent contractor agreements
• Misconceptions about short-term employees
• Overlap between independent contractors and employees’ responsibilities
• Joint employer relationships
• Permitting the individual to classify the relationship
• Providing equipment and job training
• Mandatory work hours
• Non-competition promises
Independent Contractor or Employee?

Four Examples from Recent Cases
Independent Contractor or Employee?

**Example 1: Exotic Dancers**

- Dancers sued strip clubs for overtime
- Clubs: Dancers are independent contractors, not employees
Independent Contractor or Employee?

Example 1: Exotic Dancers (con’t)

• Dancers signed leasing agreement as “independent contractors”
• Clubs did not pay dancers’ compensation, benefits, etc.
  – Dancers paid entirely by customer tips/fees (set by clubs)
  – Actually had to pay club “tip-in” fee
• Clubs set dancers’ schedules (days/shifts)
  – Dancers could work for other clubs if it did not interfere with schedule
• Clubs controlled advertising, hours, music, lighting, food/beverages sold
• Clubs regulated dancers’ appearance/apparel, behavior, ability to enter/leave clubs, visits from family/friends
Independent Contractor or Employee?

Example 1: Exotic Dancers (con’t)

Employees
- Misclassified as independent contractors
- *McFeeley v. Jackson Street Entertainment*, 825 F.3d 235 (4th Cir. 2016)
Independent Contractor or Employee?

**Example 2: Yoga Instructors**

- Non-staff yoga instructors terminated and applied for unemployment
- Studio: Instructors were independent contractors, not employees
Independent Contractor or Employee?

Example 2: Yoga Instructors (con’t)

• Studio set fees and charged customers directly
• Instructors chose to be paid hourly or percentage of fees
  – Paid only if minimum number of students attended class
• Studio set hours and licensing requirements, regulated/provided space for classes
  – Instructors signed up to teach different classes at different times
  – Not required to attend staff meetings or training
• Instructors could work/advertise for other studios
Independent Contractor or Employee?

Example 2: Yoga Instructors
Independent Contractors
• Classified correctly
• *In the Matter of Yoga Vida NYC, Inc., 28 N.Y.3d 1013 (N.Y. 2016)*
Independent Contractor or Employee?

Example 3: Orchestra Musicians

• Musicians wanted to unionize
• Orchestra challenged union’s petition for certification: Musicians were independent contractors
Independent Contractor or Employee?

Example 3: Orchestra Musicians (con’t)

• Highly skilled
• Signed up for 1-4 programs that orchestra offered each year
• Signed agreement as “independent contractors”
• Paid for each rehearsal/concert
  – Additional pay for every 15 minutes at rehearsal/concert over 2.5 hours
  – Did not withhold taxes
• Free to work for other orchestras, teach music, decline performances
• Orchestra required compliance with strict guidelines: Dress code, posture, conversations on stage, warm-up, performance
Independent Contractor or Employee?

Example 3: Orchestra Musicians

Employees

• Misclassified as independent contractors
• *Lancaster Symphony Orchestra v. NLRB*, 822 F.3d 563(D.C. Cir. 2016)
Independent Contractor or Employee?

Example 4: Freelance Blogger

• Blogger for magazine website applied for unemployment after contract expired
• Magazine contested unemployment: Independent contractor, not employee
Independent Contractor or Employee?

Example 4: Freelance Blogger (con’t)

• Well-known, established writer
• Signed year-long contract
  – Magazine paid him a monthly salary (no benefits) and issued an IRS Form 1099
• Worked from home, using own laptop, and set own hours
• Not required to post on particular topic and right to refuse story
  – Sometimes prohibited from writing about certain topics/stories
  – Magazine did not edit stories prior to posting
  – Magazine could remove posts
• No repercussions if did not post story every day
• Blogged for magazine’s competitor and wrote 8 books during contract
Independent Contractor or Employee?

Example 4: Freelance Blogger

Independent Contractor

• Classified correctly
IRS: Old 20-Factor Test

1. Instructions
2. Training
3. Integration into the business
4. Services rendered personally
5. Hiring, supervising, and paying assistants
6. Continuing relationship
7. Set hours of work
8. Full-time required
9. Doing work on employer’s premises
10. Order or sequence set
11. Oral or written reports
12. Payment by hour, week, or month
13. Payment of business or travel expenses
14. Furnishing significant tools and materials
15. Significant investment
16. Realization of profit or loss
17. Working for more than one entity
18. Making services available to general public
19. Right to discharge
20. Right to terminate
Common Law or “Economic Realities” Test

• Behavioral Control:
  – How, when, or where to do the work?
  – What tools or equipment?
  – What personnel to use?
  – Training — particularly procedures and methods

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Common Law or “Economic Realities” Test

• Financial Control
  – Compensation
    o Per hour/day/week/month?
    o Per project?
    o Benefits?
  – Expenses reimbursed?
  – Investment in equipment/materials
  – Opportunity for profit or loss?
Common Law or “Economic Realities” Test

• Relationship of Parties
  – Exclusivity of arrangement
  – Permanence of relationship
  – Written agreements
  – “Integral part” of business?
    o Skill required for the work
Varying State Tests

- States are not bound by IRS test
- Maryland: Employment status is presumed
  - Test for independent contractor status:
    - Worker “free from the employing unit’s control or direction”
    - Service provided is “outside the usual course of business of the employer”
    - Worker “customarily engaged in an independently established business”
Dos and Don’ts of Drafting Independent Contractor Agreements

• Good Drafting Practices:
  – Contract with an entity instead of an individual
  – Describe the scope of the services performed
  – Acknowledge no direction or control over independent contractor
  – Require regular invoices from the independent contractor
  – Include indemnification provisions
  – Require the independent contractor to obtain insurance
  – Set forth the length of engagement and conditions of automatic renewal, if any
  – Agree to non-exclusivity (subject to conflicts of interest)
  – Protect ownership of inventions and confidential information
  – Describe expense reimbursement requirements
  – Express mutual intent not to create employment relationship
Dos and Don’ts of Drafting Independent Contractor Agreements

• Bad Drafting Practices:
  – Too many requirements about the manner in which work is performed
    o E.g., location, work hours, equipment, reporting procedures
  – Vague descriptions of services
  – Requiring non-competition after the end of the engagement
  – Inadequate notice of termination of the engagement
  – Hourly compensation for the independent contractor
  – Contracting directly with the individual
Shall We Dance? *McFeely v. Jackson Street Entertainment*, 825 F. 3d 235 (4th Cir. 2016)

- Signed leasing agreement as “independent contractors”
- Clubs didn’t pay dancers compensation or benefits
  - Dancers paid entirely by customer tips/fees (set by club)
  - Actually had to pay club “tip-in” fee
- Clubs set dancers’ schedules (days/shifts)
  - Dancers could work for other clubs if it didn’t interfere with schedule
- Clubs controlled advertising, hours, music, lighting, food/beverages
- Clubs regulated dancers’ appearance/apparel, behavior, ability to enter/leave clubs, visits from family/friends
Shall We Dance? *McFeely v. Jackson Street Entertainment*, 825 F. 3d 235 (4th Cir. 2016)

- Dancers sue for wages and overtime, claiming they’re employees
- Clubs counterclaim for breach of contract, etc.
Shall We Dance? *McFeely v. Jackson Street Entertainment*, 825 F. 3d 235 (4th Cir. 2016)

- Trial court — Summary judgment for plaintiffs
- Appeals court — Affirmed: “...[T]he degree of control the clubs exercised here over all aspects of the individual dancers’ work and of the clubs’ operation argues in favor of an employment relationship.”
- How could employer have “fixed” this? What control would clubs have been willing to give up?
Shall We Dance? *McFeely v. Jackson Street Entertainment*, 825 F. 3d 235 (4th Cir. 2016)

- Three morals to this story:
  1. “But they agreed to be independent contractors”
  2. Guess who filed an amicus brief in support of plaintiffs?
  3. Different dancers, different dances, different results

- Studio had “non-staff” instructors it called independent contractors
- Studio set fees and charged customers directly
- Instructors chose: Hourly or % of fees
- Studio set hours, licensing requirements, class space
  - Instructors signed up for different classes/different times
  - Not required to attend staff meetings or training
- Instructors could work/advertise for other studios

- “How many rulings does it take to decide this issue?”
- **Commission of Labor**: Employees
- **Admin Law Judge**: Contractors
- **Unemployment Insurance Appeal Board**: Employees
- **Appellate Division**: Employees
- **Court of Appeals**: Contractors

- **Court of Appeals: Majority**
  - Board’s determination “unsupported by substantial evidence”
  - Non-staff paid only if certain number of students attend
  - No restrictions on where non-staff can teach
  - Non-staff free to tell students where else they’re teaching

- **Court of Appeals: Dissent**
  - Lots of evidence that non-staff were employees
  - “[T]he majority has examined the evidence before the Board and concluded that the evidence weighs more heavily in favor of a conclusion that the non-staff instructors are independent contractors. *It is the role of the Board, however, and not this Court, to weigh the factual evidence and arrive at a conclusion....If the evidence reasonably supports the Board’s choice, we may not interpose our judgment to reach a contrary conclusion.*”

- Musicians to NLRB: We’re employees, we want a union
- Orchestra: They’re contractors
- Undisputed facts:
  - Series of programs, each has four concerts
  - Orchestra sends packets to invite musicians
  - Paid by rehearsal or concert
  - No withholding
  - Agreement calls them contractors
  - Detailed rehearsal and performance etiquette

- **Regional Director of NLRB:** Contractors
- **NLRB:** Employees
  - Orchestra has substantial “control” over musicians
  - Musician’s work is part of orchestra’s regular business
- Board conducts election, union wins, orchestra seeks review
- **D.C. Circuit:**
  - 10 factors
  - Some favor “employee,” some “contractor”

- **D.C. Circuit:**
  - “Extent of control”
    - Conductor calls the shots
  - “Because the circumstances of this case thus present a choice between ‘two fairly conflicting views,’ we must defer to the Board’s conclusion that the Orchestra’s musicians are employees.”
  - Not like *Lerohl v. Friends of Minnesota Sinfonia*
    - Two musicians sue under ADA and Title VII: We’re employees
    - Court: Not everyone who follows a conductor or leader is employee
    - *Lerohl* court decided issue for itself
    - We just defer to Board

- How could employer have “fixed” this? What control would orchestra be willing to cede?

- Mitchell blogged for *The Nation* magazine
- Contract calls him “freelance” writer, paid $46,800
- He publishes eight books for other entities while under contract
- When contract not renewed, he files for unemployment

- **U.S. Department of Labor:** Employee
- **Admin Law Judge:** Employee
- **Unemployment Insurance Appeal Board:** Employee
- **Appellate Division:**
  - “We find that the Board’s decision here is not supported by substantial evidence in the record...”
    - No control; wrote for others; not permitted to work in *Nation’s* office; he chose content; general lack of supervision
Morals of the Stories

1. All of this applies to all of you
2. Playing field is tilted against your usual desire to classify workers as contractors
3. Documenting contractor relationship is necessary but far from sufficient
4. What would an outside observer observe?
Questions?

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