Contingent Workers: Employers Beware!

by Lesley A. Pate

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The contentious national discussion of immigration has drawn attention to the composition of the nation's workforce. Companies increasingly are facing liability related to the use of contingent workers, including claims brought under the Racketeering Influenced and Corrupt Organizations Act (RICO) as demonstrated by *Mohawk Indus. v. Williams*, No. 05-465, which is currently pending before the U.S. Supreme Court.[1] Recently, immigrants staged a work boycott as a visible reminder of their participation in the American workforce.

As the policy debate on immigration continues, it is clear that the nation's workforce consists of various types of relationships. In addition to the traditional employer-employee relationship, employers frequently rely upon contingent workers, such as independent contractors, temporary employees, leased employees and outsourced employees. According to the United States Department of Labor, Bureau of Labor Statistics, 5.7 million workers were classified as contingent in February 2005.[2]

Employers view contingent workers as a way to reduce taxes, employee benefit costs and administrative burdens and to avoid liability under federal and state discrimination statutes, workers' compensation laws and unemployment statutes. Employers, however, must consider the risk of and liability associated with misclassification. To most effectively advise and represent their clients, lawyers should have an understanding of the most common types of alternative work arrangements, the legal standards for determining whether an employment or joint employment relationship exists, and the attendant consequences if an employment or joint employment relationship exists.

Types of Alternative Work Arrangements

"Contingent worker" is the term commonly used to describe an individual engaged in an alternative work relationship. Employers and their lawyers should be aware of the various types of work relationships and the differences among them. The most common types of contingent workers are:

- **Independent Contractors**—Independent contractors are self-employed individu-

als retained on a contract basis to perform specified tasks. They are compensated on a contract or fee basis and are free to render service to other companies or organizations.

- **Temporary Employees**—Temporary employees are recruited, evaluated, hired and employed by a temporary staffing agency, which assigns them to work for the agency's clients. Organizations typically use temporary staffing agencies to provide workers to supplement their own workforce during employee absences, staff shortages, special projects and seasonal work. Temporary workers are supervised by the client to whom they are assigned.

- **Leased Employees**—Leased employees are employees who are on the payroll of an employee leasing firm, which leases the workers back to the company. The leasing firm processes the payroll, administers benefits, maintains records and performs other human resources functions.

- **Outsourced Employees**—Outsourced employees work for an independent firm that has been assigned specified functions by contract. Examples of functions that a company may outsource by contract to an independent firm include accounting, security, food service or human resources.

Legal Standards for Determining Employment Relationships

Companies and organizations should not mistakenly assume that using one of these types of workers will relieve them of obligations imposed on employers under federal and state law. The label or classification assigned to a particular worker or category of workers is not determinative under federal or state employment-related statutes. Rather, businesses must undertake an individualized assessment to determine whether an employment or joint employment relationship exists. The standard for whether an employer-employee relationship exists varies under the different federal and state laws. However, as discussed below, the most important and often determinative factor is control over the worker.

Equal Employment Opportunity Laws

Title VII of the Civil Rights Act of 1964 and related statutes, such as the Age Discrimination in Employment Act, prohibit discrimination against employees, but not independent contractors. Courts have consistently held that general principles of agency law guide the determination of employee status under Title VII.[3] "The key factor in determining whether a hired party is an employee under the common law of agency is the hiring party's right to control the manner and means by which the product is accomplished."[4] Other relevant factors include:

> [T]he skills required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.[5]

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The U.S. Equal Employment Opportunity Commission has issued enforcement guidance regarding the treatment of contingent workers placed by temporary agencies or other staffing firms. In analyzing whether a client firm in the temporary, leased or outsourced employee context is a "joint employer" for the purposes of the equal employment laws, the EEOC examines a number of factors, none of which is dispositive. The factors that may indicate that the worker is an employee of the client for the purposes of the equal employment laws include:

- The client has the right to control when, where and how the worker performs the job.
- The work does not require a high level of skill or expertise.
- The client, rather than the worker, furnishes the tools, materials and equipment.
- The work is performed on the premises of the client.
- There is a continuing relationship between the worker and the client.
- The client has the right to assign additional projects to the worker.
- The client sets the hours of work and the duration of the job.
- The worker is paid by the hour, week or month, rather than for the agreed cost of performing a particular job.
- The worker has no role in hiring and paying assistants.
- The work performed by the worker is part of the regular business of the client.
- The client is itself in business.
- The worker is not engaged in his or her own distinct occupation or business.
- The client provides the worker with benefits such as insurance, leave or workers' compensation.

- The worker is considered an employee of the client for tax purposes (i.e., the entity withholds federal, state and Social Security taxes).
- The client can discharge the worker.
- The worker and the client believe that they are creating an employer-employee relationship.[6]

Where a client of temporary agencies or other staffing firms exercises significant supervisory control over the worker, it will qualify as an employer of the worker.[7]

Fair Labor Standards Act

Under the Fair Labor Standards Act (FLSA), which prescribes standards for minimum wages and overtime pay, the definition of "employ" is broadly defined as "to suffer or permit to work."[8] The "economic realities" test governs the determination of whether a worker is an employee for purposes of the FLSA and considers the following six factors:

- The degree of control which the putative employer has over the manner in which the work was performed.
- The opportunities for profit or loss dependent upon the managerial skill of the worker.
- The putative employee's investment in equipment or material.
- The degree of skill required for the work.
- The permanence of the working relationship.
- Whether the service rendered is an integral part of the putative employer's business.[9]

The regulations promulgated by the Department of Labor under the FLSA clearly provide that joint employers are jointly and severally liable for compliance with the FLSA, particularly its overtime provisions. The regulations explain that a joint employment relationship will generally be considered to exist where: (a) there is an arrangement between the employers to share the employee's services; (b) one employer is acting in the interest of the other employer in relation to the employee; or (c) the employers may be "deemed to share control of the employee."[10] The Department of Labor's Wage and Hour Division has indicated that temporary workers hired through an agency to work at a particular business establishment are employees of both the agency and the business establishment in which they work.

Family and Medical Leave Act

The concept of joint employment also applies under the Family and Medical Leave Act (FMLA). Like the FLSA, the regulations promulgated under the FMLA by the U.S. Department of Labor provide that a joint employment relationship will generally be considered to exist where there is an arrangement between the employers to share the employee's services, one employer is acting in the interest of the other employer in relation to the employee, or the employers may be "deemed to share control of the employee."[11] The regulations further provide that "joint employment will ordinarily be found to exist when a temporary or leasing agency supplies employees to a second employer."[12] Under the FMLA regulations, a temporary agency is generally designated as the "primary" employer and the client is usually designated as the "secondary" employer.[13] Primary employers are responsible for providing required notices to eligible temporary employees, approving FMLA leave, maintaining the health benefits, and restoring employees to their jobs after FMLA leave.[14] The secondary employer is responsible for accepting the employee back after FMLA leave, as long as the company continues to use the service of a temporary worker from that temporary agency.[15] In addition, the secondary employer is prohibited from interfering with a temporary employee's rights under the FMLA.[16]

National Labor Relations Act

The National Labor Relations Act excludes independent contractors from the definition of employee.[17] To determine whether an employer-employee relationship exists as to a particular worker or a group of workers, the National Labor Relations Board (NLRB) applies the "common law right of control test."[18] Moreover, the NLRB consistently held that an employer is responsible for the unfair labor practices of a joint employer when the employer knew or should have known of the joint employer's unlawful conduct but either acquiesced in the conduct or failed to protest the conduct.[19] Two or more entities are joint employers of a single work force if they share or codetermine matters involving terms or conditions of employment. "Where one employer exercises meaningful forms of control over employees of the other, notwithstanding independent contractor status, the Board may find joint employer status."[20]

Virginia Workers' Compensation

For purposes of Virginia's workers' compensation law, the borrowed servant doctrine applies. "Under the borrowed servant doctrine, a worker, although directly employed by one entity, may be transferred to the service of another so that he becomes the employee of the second entity with all of the legal consequences of the new relation."[21] Like the other employment-related statutes, control over the worker is the most important consideration in determining borrowed servant status. Other relevant considerations include:

- Who has control over the employee and the work he is performing.
- Whether the work performed is that of the borrowing employer.
- Whether an agreement existed between the original employer and the borrowing employer.
- Whether the employee acquiesced in the new work situation.
- Whether the original employer terminate its relationship with the employee.
- Who is responsible for furnishing the work place, work tools and working conditions.

- The length of employment and whether it implied acquiescence by the employee.
- Who had the right to discharge the employee.
- Who was required to pay the employee.[22]

Consequences of an Employment or Joint Employment Relationship

A business that employs or jointly employs a contingent worker may be held liable or jointly liable for payroll and unemployment taxes. The contingent worker would be entitled to any employee benefits provided by the business for which the worker is otherwise qualified. If a contingent worker has been excluded from participation in a health or welfare benefit plan and is later found to be properly classified as an employee, the temporary worker may be entitled to retroactive benefits under the plan. The reclassification of workers to employees may also result in attendant consequences from the Consolidated Omnibus Budget Reconciliation Act. Because health and welfare plans are typically a matter of contract between the employer and the employee, companies and other organizations should consider specifically excluding "leased employees" and "temporary employees or workers" from their benefit plans and contracts and specifying clearly that only employees on their payroll are considered regular employees who are entitled to benefits. Companies and other organizations should also be advised to consider having their contingent workers sign agreements acknowledging that they are not employees and are not entitled to receive benefits.

Other Considerations Associated with Contingent Workers

Regardless of whether an employment or joint employment relationship exists, businesses may be required by law under certain circumstances to provide employee benefits to contingent workers. If a company maintains a qualified plan under the Employee Retirement Income Security Act, "leased employees" are automatically eligible, even if the language of the plan excludes them, to participate in a qualified plan if and when they have been employed by the business for one year. A company that offers a matching program in connection with its qualified plan needs to be aware of this eligibility requirement for leased employees because it may have to retroactively restore matching contributions to any qualifying leased employee that it previously excluded from participating in the plan. This aspect of qualified plans is frequently targeted and audited by the Internal Revenue Service.

Moreover, businesses should be advised that temporary workers that are working more than one year could be reclassified as employees by the IRS. If workers are reclassified as employees based upon length of service, the advantages of the contingent work relationship may be lost. Thus, businesses should consider whether to limit the continuous service of temporary workers to less than a year in order to minimize the likelihood that they will be reclassified as employees by the IRS.

With an understanding of the types of contingent workers and the standards under federal and state laws for determining whether an employment or joint employment relationship exists, lawyers can appropriately advise their clients and help their clients structure any contingent work relationships so as to achieve cost savings while minimizing the risk of employer or joint employer liability. ⚖

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Endnotes:

1 In *Mohawk*, current and former employees brought suit under RICO alleging that Mohawk conspired with temporary staffing agencies and other recruiters to suppress workers' wages through the recruitment and employment of undocumented workers. The Supreme Court is expected to settle a split in the circuit courts regarding whether a company and its outside recruiters, who allegedly recruited and hired illegal workers, can constitute an "enterprise" under RICO. Comments and questions during oral argument suggest that the Court may find in favor of Mohawk, holding that RICO was not intended to provide a cause of action for the claims alleged by the former Mohawk employees. A decision is anticipated by the end of June 2006.

2 United States Dep't of Labor, Bureau of Labor Statistics, *Contingent and Alternative Employment Relationships*, February 2005, at **http:// www.bls.gov/news.release/conemp.nr0.htm**.

3 *See, e.g., Atkins v. Computer Sciences Corp.*, 264 F. Supp. 2d 404, 408 (E.D. Va. 2003) (citing *Cilecek v. INOVA Healthy Sys. Servs.*, 115 F.3d 256, 259-60 (4th Cir. 1997)); *West v. MCI Worldcom, Inc.*, 205 F. Supp. 2d 531, 540 (E.D. Va. 2002).

4 *West*, 205 F. Supp. 2d at 540.

5 *Id.*

6 EEOC, *Enforcement Guidance: Application of EEO Laws to Contingent Workers Placed by Temporary Employment Agencies and Other Staffing Firms*, at **http://www.eeoc.gov/policy/docs/conting.html**.

7 *Id.*

8 29 U.S.C. § 203(g).

9 *Katz v. Enterprise Solutions, Inc.*, No 1:04cv1240 (JCC), 2005 U.S. Dist. LEXIS 37077 (E.D. Va. June 21, 2005).

10 29 C.F.R. § 791.2.

11 29 C.F.R. § 825.106(a).

12 *Id.* at § 825.106(b).

13 *Id.* at § 825.106(c).

14 *Id.* at §§ 825.106(c)-(d).

15 *Id.* at § 825.106(d).

16 *Id.* at § 825.106(d).

17 29 U.S.C. § 152(3).

18 *National Freight*, 146 NLRB 144, 145-46 (1964).

19 *See, e.g., Action Multi-Craft*, 337 NLRB 268, 277-78 (2001); *Capitol-EMI Music*, 311 NLRB 997, 1000 (1993), *enforced*, 23 F.3d 399 (4th Cir. 1994).

20 *Mingo Loan Coal Co. v. National Labor Relations Bd.*, 67 Fed. Appx. 178, 186 (4th Cir. 2003) (unpublished).

21 *Metro Machine Corp. v. Mizenko*, 244 Va. 78, 82, 419 S.E.2d 632, 634 (1992).

22 *Id.* at 83.