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Legal Risks When Using Temporary Staffing Agencies: Joint Employment, Worker Classification, Taxes, Benefits

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Overview of Contingent Labor

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What is Contingent Labor?

Some Core Definitions

- What do we mean by “contingent labor?”
  - Temporary Staffing Companies
  - Employee Leasing Companies
  - PEOs
  - Payroll Companies
  - Referral Agencies
  - Contractors
  - Customer

What is Contingent Labor?, cont.

- The National Association of Professional Employer Organizations (NAPEO) is a helpful resource
- EEOC Guidance
- Why is this a critical issue for employers?

What is Contingent Labor?, cont.

- ***Third Party Staffing Companies*** are usually tapped for transient engagements
  - Staffing companies to recruit and hire their employees
  - They are usually the W-2 employer of record
  - They handle immigration and background checks
  - Joint employment liability is seldom conceded
  - Usually used for engagements of less than one year

What is Contingent Labor?, cont.

- ***PEOs***—Usually serve as employer of record and handle payroll/benefits, but are usually not involved in recruiting;
  - Joint employment status with customer is usually established by contract
  - Customer will usually enjoy exclusive right to hire, discipline and terminate
  - PEO often offers attractive benefits plans at favorable rates based on scalability
  - PEO can also offer more sophisticated HR expertise than a small to mid-size company can muster

What is Contingent Labor?, cont.

- ***Employee Leasing*—**In many aspects this structure is similar to a PEO;
  - Employee leasing often involves targeted segments of the employer's workforce, while a PEO tends to capture a majority of the workforce in a particular country
  - The leasing company is usually the W-2 employer of record and responsible for benefits
  - Joint employment is often conceded in the contract, with the customer usually enjoying the exclusive authority to discipline and fire.
  - The leasing company may sometimes play a more substantive role in recruiting.

What is Contingent Labor?, cont.

- ***Third-Party Payroll Companies-***Usually function as a service provider of the customer/employer
  - The payroll company is not the employer of record
  - Joint employment is rarely conceded
  - Administers payroll and employment tax obligations as the agent of the employer
  - The employer retains responsibility for recruiting, onboarding, discipline and termination

What is Contingent Labor?, cont.

- ***Referral Agencies—*** usually identify workers for customer/employers
  - Referral agencies are not the employer of record
  - Referral agencies function as independent contractors of the customer/employer and co-employment is not conceded
  - Customer/employer is responsible for onboarding, discipline and termination
  - Workers referred to the customer/employer are regarded as independent contractors of the customer/employer

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LEGAL RISKS WHEN USING TEMPORARY STAFFING AGENCIES

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LEGAL RISKS OF USING CONTINGENT LABOR

- **Liability as the contingent worker's co-employer. For example,**

  > Federal, state, and local employment laws, such as anti-discrimination laws, Family and Medical Leave Act, Occupational Safety and Health Act, anti-retaliation laws

  > Workers' compensation

  > Unemployment Insurance; Short-Term Disability Insurance

  > Federal, state, and local taxes

  > Federal and state wage-hour laws; state wage payment laws

  > Employee benefits, such as health insurance, short-term and long-term disability insurance, pension or 401(k) plan

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability under federal anti-discrimination laws -- e.g., Title VII, Age Discrimination in Employment Act, Americans with Disabilities Act -- state anti-discrimination laws, and local anti-discrimination ordinances

→ Lost wages and benefits, reinstatement, actual damages, punitive damages, attorneys' fees

> Potential liability under Family and Medical Leave Act

→ Lost wages and benefits, actual damages, such as cost of providing care (up to 12 weeks), liquidated damages, attorneys' fees

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability under Occupational Safety and Health Act

→ Citations/penalties for failure to provide a safe workplace/ failure to comply with OSHA standards

→ Costs of compliance

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability under anti-retaliation statutes, for wrongful discharge in violation of public policy, and under whistleblower statutes

→ Actual damages, punitive damages, reinstatement, backpay, attorneys' fees

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Misclassifying contingent workers as non-employees/independent contractors

> Workers' compensation

→ Potential liability for premiums and workers' compensation benefits

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Misclassifying contingent workers as non-employees/independent contractors

> State unemployment insurance laws

→ Potential liability for state unemployment insurance taxes

> State disability benefits laws (CA, HA, NJ, NY, RI)

→Potential liability, depending on the state, may include amount of mandatory employee payroll deductions, employer contributions, amount of benefits

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Misclassifying contingent workers as non-employees/independent contractors

Potential liability for federal, state, and local taxes

> Unpaid federal, state, and local taxes, penalties, and interest

> Taxing agencies share information

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability under Fair Labor Standards Act and state wage-hour laws

→ Unpaid overtime, particularly where individuals were misclassified as exempt fom overtime, liquidated damages, attorneys' fees

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability under state wage payment laws

→ Unpaid final wages

→ In some states, unpaid vacation pay

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability for failure to provide health insurance coverage if not lawfully excluded from the plan

→ Penalties for violation of ERISA rights

→ Lost benefits, attorneys' fees

→ Loss of tax-qualified status

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability for failure to provide COBRA continuation notices

→ Damages, attorneys' fees, statutory penalties, excise tax penalties

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Misclassifying contingent workers as non-employees/independent contractors

> Potential liability under the Affordable Care Act for failure to offer coverage to temporary workers who nevertheless qualify as full-time employees, unless employer takes credit for offer of health insurance by the staffing agency

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Misclassifying contingent workers as non-employees/independent contractors

> 401(k) plan

→ Potential liability for corrective contributions and risk of disqualification for impermissibly excluding temporary employees from 401(k) plan – as opposed to requiring employees to work up to 1,000 hours of service in a year before permitted to participate in the 401(k) plan

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Misclassifying contingent workers as non-employees/independent contractors

> Other employee benefits, such as holiday pay, vacation/sick days/PTO

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Misclassifying contingent workers as non-employees/independent contractors

> National Labor Relations Act

→ Possibility that temporary employees would be determined to be part of the bargaining unit and entitled to vote in representation election

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Joint employment – the current legal landscape

> In the context of a staffing agency supplying temporary workers to a client, the client (or the staffing agency) may have employment liability under a "joint employer" theory.

> Joint employer liability can arise in numerous contexts, including the anti-discrimination laws, workers' compensation, and other areas discussed in the "Legal Risks of Using Contingent Labor" portion of this webinar.

>Tests for determining joint employment vary by jurisdiction and by statute and regulation. Also, different federal and state agencies use different joint employer tests. Examples are presented in slides that follow. These are just examples.

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Joint employment – the anti-discrimination laws

> Title VII of the Civil Right Act of 1964

→ The courts are not in agreement on the test for whether the entity that is not the direct employer can be the individuals' employer (that is, joint employer) under Title VII.

→ Some courts apply a five-factor "economic realities" test: (1) the extent of the employer's control and supervision over the worker, including directions on scheduling and performance of work, (2) the kind of occupation and nature of skill required, including whether skills are obtained in the workplace, responsibility for the costs of operation, such as equipment, supplies, fees, licenses, workplace, and maintenance of operations, (4) method and form of payment and benefits, and (5) length of job commitment and/or expectations. Of these factors, the employer's right to control is the most important and is given the most weight. *Frey v. Coleman,* 903 F.3d 671, 676 (7th Cir. 2018).

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Joint employment – the anti-discrimination laws

> In *Odongo v. Brightpoint N. Am., L.P.,* No. 1:16-cv-00685-TWP-DML, 2018 U.S. Dist. LEXIS 161688, at *10-11 (S.D. Ind. Sept. 21, 2018), the court, applying the economic realities test, held that an employee working for a temporary employment agency may be considered an employee of the entity to which he is assigned for purposes of Title VII where the entity exerts a significant amount of control over the individual, and the facts that the employee is employed directly by and received his paychecks from the agency are not dispositive.

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Joint employment – the anti-discrimination laws

> Other courts apply the common-law agency test. In *United States EEOC v. Global Horizons, Inc.,* 915 F.3d 631, 638-39 (9th Cir. 2019), the court rejected the economic realities test and applied the common-law agency test to its joint employer analysis. The court stated that under the common-law test, the principal guidepost is the element of control – that is, the extent of control that one may exercise over the details of the work of another.
(continued on next slide)

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Joint employment – the anti-discrimination laws

> *Global Horizons* (cont'd): The court gave a non-exhaustive list of factors to consider when analyzing whether the requisite control exists: the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the 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.

"There is no shorthand formula for determining whether an employment relationship exists, so all of the incidents of the relationship must be assesses and weighed with no one factor being decisive."

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Joint employment – the anti-discrimination laws

> Still other courts apply a "hybrid" test, which looks to common-law master-servant agency principles, "tempered by a consideration of the economic realities of the hired party's dependence on the hiring party." *Ashkenazi v. S. Broward Hosp. Dist.,* 607 Fed. Appx. 958, 961 (11th Cir. 2015).

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Joint employment – the current legal landscape

> Fair Labor Standards Act

→ In determining whether a joint employment relationship exists under the FLSA, most courts use the economic realities test. *E.g., Ash v. Anderson Merchandisers, LLC,* 799 F.3d 957, 961 (8th Cir. 2015). The court stated that to determine the economic reality of the relationship between an employee and a purported employer, courts consider whether the purported employer (1) had the power to hire and fire employees; (2) supervised and controlled employee's work schedules or conditions of employment; (3) determined the rate and method of payment; and (4) maintained employment records. "These factors are not exhaustive, and no one factor is dispositive.." "The overarching concern is whether the alleged employer possessed direct or indirect power to control significant aspects of the plaintiff's employment."

→ In a regulation under the FLSA, 29 C.F.R. §791.2, the Wage and Hour Div. of the US DOL essentially takes the position that joint employment is presumed unless the two (or more) employers are acting entirely independently of each other and are completely disassociated with respect to the employment of the particular employee.

→ US DOL is expected to update its regulation concerning joint employment, but it is not known whether and when that willa ctually happen, or whether US DOL has the authority to do so.

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Joint employment – the current legal landscape

> State wage-hour laws

→ The economic realities test is used to determine joint employer status under many state wage-hour laws. E.g., under the Missouri Minimum Wage Law, the courts evaluate joint employment based on four factors: (1) who has the power to hire and fire the worker; (2) who supervises and controls the worker's work schedule and conditions of work; (3) who determines the rate and method of payment of the worker; and (4) who maintains work records. *Tolentino v. Starwood Hotels & Resorts Worldwide, Inc.,* 437 S.W.3d 754, 758 (Mo. 2014).

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Joint employment – the current legal landscape

> State wage-hour laws

→ In CA, CA Labor Code §2810.3 holds businesses accountable for wage and hour violations when they use staffing agencies.

→ The joint employment test under the CA IWC wage orders is a broad one and includes both temporary employment agencies and employers who contract with such agencies to obtain employees. In *Dynamex Operations W. v. Superior Court,* 4 Cal. 5th 903 (2018), the CA Supreme Court broadened the test for determining who is an employee in the independent contractor context – the "ABC test." Employers and staffing agencies were concerned that the broad ABC test might apply in the joint-employer context, but a CA Court of Appeals found that the Court in *Dynamex* did not intend for the ABC test to be applied in joint employment cases. *Curry v. Equilon Enterprises, LLC,* 23 Cal. App. 5th 289, 314 (2018).

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Joint employment – the current legal landscape

> Family and Medical Leave Act

→ Under the FMLA, a joint employment relationship generally will be considered to exist in situations such as (1) where there is an arrangement between employers to share an employee's services or to interchange employees; (2) where one employer acts directly or indirectly in the interest of the other employer in relation to the employee; or (3) where the employers are not completely disassociated with respect to the employee's employment and may be deemed to share control of the employee, directly or indirectly, because one employer controls, is controlled by, or is under common control with the other employer. No one factor is determinative.

→ "Joint employment will ordinarily be found to exist when a temporary placement agency supplies employees to a secondary employer." 20 C.F.R. §825.106.

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Joint employment – the current legal landscape

> National Labor Relations Act

→ The National Labor Relations Board considers both the putative employer's reserved right to control and its indirect control over the employees' terms and conditions of employment as factors for determining whether businesses should be considered joint employers. *Browning-Ferris Industries of Calif., Inc. v. NLRB,* 911 F.3d 1195 (D.C. Cir. 2018)

→ In September of 2018, the NLRB published a Notice of Proposed Rulemaking in the Federal Register regarding its joint employer standard. Under the proposed rule, an employer may be found to be a joint employer of another employer's employees only if it possesses and exercises substantial, direct, and immediate control over the essential terms and conditions of employment and has done so in a manner that is not limited and routine. Indirect influence and contractual reservations of authority would no longer be sufficient to establish a joint-employer relationship. Comments were due on 1.28.2019, and comments replying to the comments were due 2.11.2019.

This new standard may encourage outsourcing of labor to staffing agencies.

Staffing Companies, The Gig Economy and The Modern Workforce - Domestic/International Issues & Considerations

What is the “modern workforce”?

- Includes all staffing models that fall outside the traditional employer-employee relationship
- More flexible and global, consisting, among others, of freelancers, terms, agency workers and crowd sourcing
- As the pace for technology change and need for technology increases – numbers are expected to rise. For example:
  - estimated 1.3 million people in the UK are engaged in the gig economy
  - 31 million workers in the US are predicted to be contingent by 2020

Examples: global businesses?

Platform/crowd work

Where an online platform matches businesses with specific needs to workers with the appropriate skills — with larger tasks, the work is often split among a number of people drawn from a "virtual cloud" of workers.

Collaborative employment

Where a group of freelancers or small organizations might club together creating the scale to offer services to much bigger clients.

Contractors/freelancers

While these models are not new, the size and scale of businesses' deployment of these models is growing.

Casual work

Where the employer is under no obligation to guarantee work but can call on workers on demand, say, at times of peak production or activity. This is a common feature in a number of jurisdictions with most national regulations including some level of protection in terms of pay rates or minimum hours.

ICT-based mobile work

Where workers can do their job from any place at any time, supported by modern technology. This is common in certain sectors like IT, but could be further adopted across a wide variety of sectors.

Agency/employee provision/leasing

Where employees are retained by a professional employer organization or company for them to work for the organization's client or business.

Portfolio work

Where a self-employed, often highly skilled individual completes work for a number of clients.

Mobile contingent workers

Individuals who are engaged as contingent workers under temporary, part-time or "independent" positions and who are deployed to other countries to fill short- or long-term engagements.

Benefits

- Cost saving
- Avoid administrative burdens
- Flexibility
- Quick access to high-level talent

Risks

•Employee misclassification
•Data privacy/cyber breaches
•Litigation, fines/penalties (i.e., illegal labor lending)
•Immigration breaches
•IP/confidentiality breaches
•Lack of loyalty/reputational risk
•Unfair competition/non-compete obligations

Focus on Misclassification—Global Concerns

- One of the most significant risks posed by the modern workforce is misclassification
- Existing legislation often inflexible and unsuited to some models, such as platform or crowd employment;
- trend in UK courts toward classifying platform workers as “workers” (intermediate status between employment and self-employment)
- Is the UK “worker” classification a harbinger of what will happen in the US?
- What’s happening in Asia—the role of “dispatch workers”

Focus on Misclassification

- A jurisdiction may limit the use of temporary agency workers
- Misclassification is one area where factors generally are similar country to country
- Some considerations (but always check local country/state law!)
  - degree of control exercised by the company
  - whether the individual uses their own equipment
  - whether the individual hires their own employees and/or has their own clients
  - whether the individual is regarded as part of the company's organization or integral to the business

Focus on Misclassification

  - whether the individual was provided benefits
  - the parties' own views of their relationship
- A jurisdiction may prohibit certain types of outsourcing (for example, some countries in Latin America), which may restrict flexibility and increase legal risks with respect to certain types of work arrangements.
- Consequences of misclassification can be quite severe, including not only the obligation to make mandatory labor and separation payments, but also the obligation to pay mandatory social contributions and/or social benefits not received by the individual due to the company's noncompliance.

Focus on Misclassification

- Fines may also apply in certain cases.
- Some countries impose caps on the percentage of contingent workers.
- Some countries will cap the duration of any contingent relationship. For example, workers with 12-18 months may be deemed to be employees of the customer regardless of the terms of the Agreement

BEST PRACTICES FOR CONTRACT DRAFTING

Staffing Company Agreements—Customer Concerns

- Practical Consideration—Is there room to negotiate?
- Strategic Considerations—What is the end game?
  - Short term labor supply;
  - Temp to perm;
  - Other
- Key Provisions
  - Vendor is an independent contractor
  - Commit to position on joint employer risks
  - Background Screening and Immigration Compliance

Key Contractual Considerations—Cont.

- Compliance With Laws
  - Termination Rights and advance notice
  - Each temp should be an employee of the staffing company.
  - Avoid receiving the staffing company's contingent personnel
  - Discipline and termination—Who can fire staffing company employees?
  - Responsibility for Compensation and Benefits
  - Signed disclaimers from each assigned employee
    - Confirming no employment relationship with customer
    - Confirming no entitlement to comp and benefits from customer

Key Contractual Considerations—Cont.

- Insurance
  - workers comp
  - Occupational Health & Safety
  - Professional/CGL
  - Public Liability
  - EPL
  - Customer named as additional insured

Key Contractual Considerations—Cont.

- Protect IP and Confidential Information Where Appropriate
  - From Staffing Company
  - From assigned personnel
  - Reliance on a Common Agreement Signed by Assigned Personnel
  - Force Majeure—Don’t forget it. It can protect both sides
  - Dispute Resolution
    - Arbitration?
    - Arbitration for the assigned workers?

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Risk mitigation

> Businesses that intend to use a staffing agency should consider doing the following:

→ Research the staffing agency – how many clients and what type of clients do they serve? How long have they been in business? Conduct a litigation search to determine if the agency has a litigation history. Ask for references. Talk to clients of the agency.

→ Does the agency have Employment Practices Liability Insurance? Does the policy name the client as an additional insured? What types of claims does the policy cover?

→ Require proof of workers' compensation coverage.

→ Review the agency-client agreement. (Continued on next slide.)

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Risk mitigation

> Matters to address in the staffing agency – client agreement (from client's perspective):

→ Agency's responsibilities: Recruit, screen (background checks, drug tests), interview employees; pay employees' wages and provide agency's employee benefits; pay, withhold, and transmit payroll taxes; discipline and termination; provide workers' compensation and handle workers' compensation claims; provide unemployment insurance and handle unemployment insurance claims; require assigned employees to sign confidentiality agreements and agreements acknowledging that they are not entitled to any benefits offered or provided by the client.

→ Agency guarantees that assigned employee will have qualifications that client requests.

→ Agency has right to control assigned employees' activities.

→ Agency is in compliance with Immigration Reform and Control Act of 1986, Internal Revenue Code [and other named laws].

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Risk mitigation

> Matters to address in the staffing agency – client agreement (from client's perspective): (continued from previous slide)

→ Indemnification from agency – all damages arising out of agency's performance under the agreement – duty to defend before determination of liability

→ Indemnification against ACA liability for assigned employees.

→ Health coverage offered by agency will be viewed as offered by client provided client pays a higher fee reflecting coverage offered.

→ Employment practices liability insurance – client named as additional insured – scope of claims and damages covered?

→ Commercial general liability insurance – client named as additional insured

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Risk mitigation

> Matters to address in staffing agency – client agreement (from agency's perspective):

→ Client to properly supervise assigned employees; not change assigned employees' duties without agency's approval

→ Billing rates; payment terms

→ Reciprocal indemnification

→ Working conditions, and (where necessary) safety training, and personal protective equipment

→ Reciprocal provision on compliance with laws

→ No solicitation or hiring of assigned employee during term of agreement and for X period thereafter without agency's permission

→ Client has anti-discrimination/harassment/retaliation policy and procedures

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