

Chapter 1

Employment Law Overview



“If you have to support yourself, you had bloody well find some way that is going to be interesting.” —Katharine Hepburn, actor and four-time Oscar winner

Learning Objectives

1. Recognize how governmental agencies and jurisdictions apply different tests to characterize the worker relationship.
2. State the factors suggesting that a worker is an employee.
3. Distinguish between an employee and an independent contractor.
4. Describe the advantages of using an independent contractor.
5. State the risks of misclassifying the status of workers.

Chapter Outline

- Introduction
- Sources of Employment Law

- Federal, State, and Local Laws and Ordinances
- Defining the Worker
- The Employment Relationship
- Employee Status Under Common Law
- Federal Law “Economic Realities” Test
- Employee Status Under Federal Labor Law
- Proposed Restatement Definition

Case 1.1 Lemmerman v. A.T. Williams Oil Co.

- The Worker as Independent Contractor
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- The Worker as Leased Employee
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Chapter Opening scenario

Martin Farms was a grower in upstate New York. It retained migrant workers to help in its harvesting operations through Ramey Farms, a Texas-based labor contractor. Ramey recruited and supplied 42 farm workers from Arizona, who traveled to New York State to harvest cabbage and squash for Martin Farms. The workers did not receive written contracts. Representatives of Ramey Farms orally promised them \$6.00 per hour, ten hours or more of work per day, free housing, and transportation to and from New York. While Martin Farms exercised very little day-to-day control over Ramey's recruitment and management of the migrant workers, it did dictate when the recruitment would occur. Ramey arranged for most of the recruiting logistics and managed the workers once they arrived in New York. Martin Farms exercised power by giving Ramey instructions, and it expected that its instructions would be followed. Martin Farms instructed Ramey not to use a particular work crew the following year and dictated the maximum amount of hourly wage the workers were to be paid. Ramey controlled the workers' payroll, and Martin Farms paid Ramey a per-employee/per-hour fee to cover all of the workers' costs. The migrant farm workers sued Martin Farms because they claimed that while working in New York, Martin Farms provided substandard housing, did not pay all the wages due, and did not provide them with transportation back to Arizona when the work was completed. In considering the migrant workers' claims, the court had to determine whether Ramey Farms acted as both an independent contractor to Martin Farms and as an authorized agent of Martin Farms, subjecting Martin Farms to legal liability to the workers. What reasonable conclusion should the court reach?¹

Introduction

Employers attempt to structure and apply their employment practices to comply with the nation's laws relating to the employment of workers. The law's broad scope reaches every aspect of the employer-worker relationship. Often, employers find it difficult to recognize when and how to apply a particular law or regulation to their business. Their compliance obligations are made more complex because of overlapping statutes, regulations, and ordinances. Tens of thousands of court decisions, regulatory agency interpretations of laws, public policies, as well as evolving societal standards continually challenge managers, compelling them to stay informed about employment and discrimination law. The failure to understand and properly apply the law can expose the employer to great financial risk. While a private employer may classify and treat its workers in one manner, governmental regulation and enforcement can require a contrary result. Legislatures, courts, and administrative agencies have long been involved in that relationship. Rooted in contract and agency law, employment law is

the subject of considerable government regulation. Concerned over what rules should regulate businesses and their employees, government has aggressively intervened in the business–worker relationship.

In this chapter, we will study the sources of both the laws that govern the worker relationship of the laws that define differences among worker classifications. We will focus on the factors utilized by courts and administrative agencies to extend employment status protections to workers. By properly planning and administering the worker relationship, managers can avoid exposure to legal liabilities and can aid in protecting both worker and employer rights.

Sources of Employment Law

The Civil and Public Branches of the Law

Initially, the study of employment and labor law can appear daunting; however, classifying their parts makes them understandable. The employment relationship is governed by a complex set of **laws, rules, and regulations**. Collectively referred to as the “**law**,” these mandates govern the social and economic order among individuals and their relationship to society. What constitutes the **law** is selected by society to regulate personal and business conduct. The **law** acts as a common bond and promoter of civil behavior among societal members. There are two major categories of **law**; namely, **civil law**, which involves private disputes, and **public law**, which governs a person’s personal rights and obligations in relation to government. Our studies of contract law (including its application to covenants not to compete and nondisclosure of trade secrets) and tort law (which addresses wrongful conduct within the employment relationship) involves the **civil law** branch. Other features of **civil law** include property law, inheritance, family law, and the law relating to business entities. The **public law** branch of our law tree includes criminal law, relating to offenses against society; constitutional law, relating to individuals’ rights and relationships to their local, state, and federal governments; administrative law, which focuses on the powers of executive branch administrative agencies; and international law, which involves the legal relationships among nations. Employment and labor law involves many of these topics, and we shall address them in our course of this study.

This study will draw on many documents from the federal, state, and local government levels. These include federal and state **constitutions, statutes, and executive orders**; local **ordinances**; the **rules, regulations, and orders** of administrative agencies; and published decisions of federal and state courts. The “**law**” refers to statutory enactments by Congress and state legislatures as laws as well as those issued by counties and municipalities as **ordinances**.

The sources governing the work relationship include the following:

- **Constitutions.** Both federal and state governments operate through a legal system by which rights are granted to the government by the people to be governed. The people establish the rights and duties of the government and of the people and the relationships between government and governed.

Law

Mandates that govern the social and economic order among individuals and the individual’s relationship to society.

Ordinance

A law enacted by a local jurisdiction such as a county, borough, or municipality.

- *Examples:* The United States Constitution, as amended and state constitutions.
- **Federal, state, and municipal statutes and ordinances.** Legislative branches issue written commands to promote or prohibit conduct.
 - *Examples:* **Title VII of the Civil Rights Act;** Occupational Safety and Health Act; N.Y. Civil Rights Law; and Austin, Texas, Code of Ordinances, Vols. I–IV.
- **Administrative rules and regulations.** Created by each branch of government under a grant of authority to provide services, administrative agencies issue directives and decisions in certain areas of interest.
 - *Examples:* Equal Employment Opportunity Commission, Department of Labor, Internal Revenue Service, and state workers' compensation agencies.
- **Judicial decisions.** Judicial decisions interpret the acts of the executive and legislative branches and litigants.
 - *Examples:* Published court decisions that have been made determining whether laws were constitutional, resolving a claim for wrongful termination of employment, or enjoining a party from disclosing trade secrets to a competitor.
- **Executive orders.** Executive orders, issued by the president or a governor to executive branch agencies, promote or prohibit policy decisions.
- **Contractual agreements.** Contractual agreements exist between the employer and the employee.
 - *Examples:* Employment agreements, employment manuals, and practices, and collective bargaining agreements.

Executive Order
Directives by the chief executive to executive branch departments to promote, prohibit, or inhibit conduct relating to the executive's policy decisions.

The Law Defines Rights and Duties

These sources of **law** recognize a **legal right** and **duty** as two fundamental aspects of the **law**. Each must coexist with the other. A **legal right** is the ability to have an individual interest respected by others and enforced through court process. A **legal right** is recognized in many settings. It can arise from a two party contract, or it might be a freedom recognized and enforced by the government or a private party. A **legal duty** is imposed on an individual either by contract or by applicable law as a requirement not to interfere with the legal interests of another. It is the standard of care that society expects every person to exercise with regard to others. Sometimes duties are imposed by statutes or local ordinances and at other times by judicial decisions.

Substantive and Procedural Law

Recognition of **legal rights** and **duties** occurs in the context of **substantive** and **procedural laws**. The **substantive law** establishes by statute and case precedents the principles and definitions of rights and legal relationships. We will spend most of our study of employment and labor law (i.e., the law governing management and a unionized workforce) reviewing their **substantive law** aspects. The **procedural law** addresses the means and methods of the legal process, by which private dispute resolution forums, administrative agencies, and courts handle the resolution of disputes over **substantive** legal rights.

Checks and Balances

Each branch of government created by the federal or state **constitution** is equal to the other branches. The legislative branch enacts laws that govern the rights and responsibilities of persons in the employment law context. The executive branch is charged with the enforcement of the laws. To assist the executive branch, many **administrative agencies** have been created to administer employment and labor law. Most agencies are within the executive branch of government; they possess the legal authority to affect the rights of private persons through their **rules, regulations, and orders**. Examples of such agencies include the U.S. Department of Labor and the Equal Employment Opportunity Commission. They are given their authority by Congress in recognition of the increasing complexity of our society.

Congress, and its state counterparts, may enact an **enabling statute** that creates an agency to which it can delegate the power to issue **rules, regulations, and interpretative orders** to put into effect its mandates. Recognized as having special expertise in an area of law, **administrative agency** decisions are afforded considerable weight by the courts in considering agency actions. The **judicial branch** is known as the court system, and its responsibility is to interpret and apply the **laws, rules, and regulations** created by the legislative and executive branches of government and to determine private disputes. The consequence of establishing separately instituted forces to exercise governmental power is known as the American system of **checks and balances**.

The Role of the Judicial Branch

American law traces its development to the laws of England. With their conquest of England in 1066, the Normans brought to England a King's court system by which the common application of uniform rules was sought. This became known as the "**common law**." Over time, English **common law** put the rights of the people ahead of those of the crown. As needs arose, the English courts developed various remedies to address changing damage claims. Courts of equity, wherein nonmonetary remedies were available if money damages were inadequate, soon joined law courts that gave only monetary remedies. Nonmonetary remedies were used to rescind contracts, issue orders of specific performance of contractual terms and conditions, and enjoin some action of a party. From the **precedent** of early English **common law** court decisions, American courts began to develop a body of law and procedures to adjust the duties and responsibilities of the employer and the employee.

The U.S. court system is a common law system that relies on the **adversary system** for the **adjudication** of matters. In this system, a party to a lawsuit files an appropriate court pleading to commence the proceedings in a proper court. The **trier of fact**, whether a judge or jury, determines the facts. The court applies the law to the dispute for a final determination between the parties to the suit. This process is known as **adjudication**. In contrast to this system, countries that adopt a **civil law** system employ judges who investigate the facts and conduct the presentation of evidence.

As the body of court decisions grew, the **common law** adopted a practice employed by American courts known as **stare decisis**. Under this doctrine, lower courts, in considering similar cases, must apply the decision of the highest court in a jurisdiction on the subject at issue. Lower trial courts in both federal and state venues are required to

follow *stare decisis* until the higher court reverses or amends its prior decision. Until then, the decision of the higher court is followed as binding **precedent** by all lower courts in that jurisdiction.

Article III of the U.S. Constitution established the federal court system. The federal courts have the power or **subject-matter jurisdiction** to decide those cases that Congress authorizes them to decide, except for matters relating to the constitutionality of an act of Congress or the executive branch. The federal court system is premised upon two types of **subject-matter jurisdiction**. The first is known as **federal-question jurisdiction**, in which the federal courts have the authority to decide a dispute arising under federal law. Disputes arising under the federal employment laws we will study may be decided by federal courts under federal-question jurisdiction. Other federally controlled disputes are resolved through the actions of a federal **administrative agency**, such as the National Labor Relations Board. Along with federal trial court decisions, the decisions of federal administrative agencies on matters affecting employment and labor law may be appealed to federal courts of appeal.

The second type of subject-matter jurisdiction is **diversity jurisdiction**, in which the amount in controversy exceeds \$75,000 and all parties to the litigation are diverse in their citizenship. Generally, this means that the parties to the employment lawsuit are citizens of different U.S. states. Under the Class Action Fairness Act of 2005, a class-action lawsuit may be brought in federal court when there is even minimal diversity, which means that any plaintiff is a citizen of a different state from any defendant. Employment and labor law disputes are often heard in federal courts based on these two types of **subject-matter jurisdiction**.

The primary trial courts of the federal court system are the United States District Courts. There are 94 federal judicial districts throughout the United States and its territories. There is at least one district court in each state, the District of Columbia, and Puerto Rico. Three U.S. territories, the Virgin Islands, Guam, and the Northern Mariana Islands, have district courts that hear federal cases. Decisions of these courts may be appealed to the United States Courts of Appeals. There are thirteen federal courts of appeals. They are geographically defined for areas of the country. All the courts of appeals hear appeals from some administrative agency decisions and rulemaking; however, most of those are heard in the U.S. Court of Appeals for the Federal Circuit in Washington, D.C. The courts of appeals are considered powerful and influential in setting case precedents within the federal court system. The decisions of the federal courts of appeals serve as the final decision in most federal court litigation. Federal courts of appeals' decisions serve as binding precedent for all lower federal courts (i.e., federal district courts and bankruptcy courts) within that circuit. Lower federal courts must follow the binding precedent under the *stare decisis* doctrine in deciding future similar cases.

The U.S. Supreme Court accepts a little over one hundred cases each year for review. For most types of cases, there is no right of automatic appeal to the Supreme Court; rather, the Supreme Court selects the cases that it wishes to hear. When a party to a case desires the Supreme Court to hear it, where no appeal is available as a matter of right, the party formally petitions the Supreme Court to grant a writ of certiorari. A minimum of four of the nine justices must agree to grant a writ of certiorari. When a writ is issued, the Supreme Court is certifying to the lower federal court that the Supreme Court will review the case. Only matters of great legal significance or ones involving a split of opinion among the circuit courts of appeals are typically granted a writ. If a writ of *certiorari* is denied by the Supreme Court, the decision of the lower court remains unaffected.

Federal, State, and Local Laws and Ordinances

The Federal Constitution

The founding fathers ensured that the supreme law of the land would be the United States Constitution. Article VI sets forth the **Supremacy Clause**:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary notwithstanding.

Federal law controls a significant portion of the law of employment. State legislatures, **administrative agencies**, and courts may provide for other rights and remedies in this context provided they do not conflict with applicable federal law. In the event of such a conflict, federal law prevails. Under the **Supremacy Clause** of the U.S. Constitution, the offending state law or local ordinance is unconstitutional. In an 1819 decision of the U.S. Supreme Court in *McCulloch v. Maryland*, 17 U.S. 316 (1819), Chief Justice John Marshall wrote, “In every such case, the act of Congress, or the treaty, is supreme; and the law of the State, though enacted in the exercise of powers not controverted, must yield to it.”

Whenever Congress enacts laws within its power, the resulting legislation **pre-empts** or overrides any conflicting state law. Through federalism, the state laws defer to the national policy interests that underlie the federal law. Congressional power to enact legislation is broadly interpreted, and even its intention to preempt a given area of the law will preempt nonconflicting state and local law. When no such congressional action has occurred or been expressed, then nonconflicting state and local law is permissible. For example, Congress can enact a discrimination law that covers 15 or more employees, but a state may enact a similar law protecting other forms of discrimination covering fewer than 15 employees. In such a case, the employer would be required to conform to both the state and federal laws.

In a similar manner, when federal **administrative agencies** issue rules or regulations they have the same **preemptive** effect on those issued by their state or local agency counterparts. Careful human resource managers and employers must recognize the myriad sources of the legal principles governing the operation of their businesses.

The laws and regulations issued under federal and state **laws** and local **ordinances** may apply simultaneously to covered employers. They are to be read together to give the maximum protection to the employee. While they quite often address the same areas of conduct, they are to be reviewed as if they both applied to the same situation.

In the area of civil rights, Congress acknowledges that federal legislation will be read in concert with state and local laws. Thus, federal civil rights statutes, such as the Civil Rights Act of 1964, whose primary employment law section is referred to as Title VII, do not **preempt** state and local discrimination laws. Compliance with one applicable law, therefore, does not discharge the employer’s responsibility to comply with the requirements of other applicable laws.

When a state law or local ordinance affords more protection than that offered by federal law, that law or ordinance is not preempted (i.e., displaced) by the federal law.

Preempt

The legal doctrine by which the laws of a higher authority displace the application of laws issued by a lower jurisdiction when the lower jurisdiction’s laws conflict with those of the higher jurisdiction.

In such circumstances, the federal, state, and local law will be read together. Many state laws, for example, afford more protection to the worker than federal law allows. Examples of such laws include state wage and hour laws requiring employers to pay more than the federal minimum wage rate and more stringent state safety and health requirements than those required by federal health and safety laws and regulations. The responsibilities of human resource managers, compliance officers, and their legal counsel continue to expand as the **laws, rules, and regulations** change each year on the federal, state, and local levels.

The Equal Employment Opportunity Commission (EEOC) provides guidance for employment issues by creating guidelines for employers to follow. Unlike Congressional legislative mandates to the courts or when *stare decisis* applies, trial and appellate courts are *not* required to follow the EEOC guidelines. *Stare decisis* is a legal principle by which judges are required to follow prior legal precedents established by prior decisions. In all states except Louisiana, which follows a mixed system of common law and civil law, trial and intermediate appellate courts must follow and apply prior precedent that applies in a particular case. Courts, however, have looked to the EEOC for guidance in analyzing facts presented by litigants.

Defining the Worker

For most of the last century, the federal government has been increasingly involved in how an employer defines a worker as either an **employee** or an **independent contractor**. On its website, the Internal Revenue Service (IRS) states:

It is critical that you, the business owner, correctly determine whether the individuals providing services are employees or independent contractors. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. . . . In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.²

A universal rule or formula does not exist to determine whether an individual worker is an **employee** or **independent contractor**. Depending on the situation, the term *employee* can have many different meanings. An **employee** is defined as a person who acts under a contract in the service of another who has the right to **direct and control** the person in the means and methods of how the services are performed. In contrast, an **independent contractor** is defined as a person who exercises independent judgment in the means and methods of performing work for the person with whom the independent contractor has contracted. Generally, the determination of whether a person is an **employee** or an **independent contractor** must be made upon the particular facts in each case. Multiple factor tests exist among federal, state, and local jurisdictions to aid in this determination. The lack of a common rule for defining a worker's status has been a troublesome issue for employers, **employees**, governmental agencies, and the courts.

Properly classifying someone as an **employee** or under some other status can present serious legal and economic consequences for the business owner. An employer's practice in classifying a worker under one statute may be found in violation of an

Independent Contractor

A nonemployee worker who exercises independent judgment in the means and methods of performing work for and under contract with a principal.

employee's rights relative to a different statute. The determination of employment status is very important in this field of the law. Compliance with complex tax laws and regulations and the legally compelled need to provide fringe benefits and absorb liability for employee torts and discriminatory actions are all duties imposed on an employer relative to a worker classified as an **employee**.

The Employment Relationship

A commonly used definition of an **employee** is “[a] person who works in the service of another person (the employer) under an express or implied contract of hire, under which the employer has the right to control the details of work performance.”³ That simple statement is subject to myriad interpretations and statutory constructions, most aimed at defining the status of the worker in light of the purposes for which the statute or doctrine was adopted. Courts rarely accept, without further inquiry, an employer’s classification of its workers as controlling. The actual circumstances of the work relationship guide the courts, not the characterization given by the parties. This is especially true in cases involving the extension of worker protection laws that bar waiver of statutory rights. As an example, workers’ compensation laws provide medical coverage and lost-wage protection to **employees** who are injured on the job but bar these workers’ from suing the employer directly for those injuries and damages.

Example: If a worker who has been under the direct control of a business owner and is injured operating equipment provided to the worker at the owner’s place of business, the worker should be able to receive workers’ compensation benefits for job-related injuries. Even if the business owner characterizes the worker as an independent contractor rather than an employee, the worker’s entitlement to those benefits will remain.

Before we begin our review of the various “tests” courts apply to determine **employee** status, we must recognize one important exception to the basic principle under which **employees** are classified according to the purposes of the National Labor Relations Act. The National Labor Relations Act, a subject of a later chapter in our text, governs the employer-unionized workforce relationship. Under that act, Congress defined the worker as an “**employee**” under the common law, but it excepted from its protection those workers who were in **supervisory** or **managerial** positions.

Perhaps most telling of the confusion regarding the law’s classification of **employee** status is a comment from a 1999 U.S. Department of Labor fact-finding report:

The Commission concludes that the ancient doctrine of master and servant provides a poor vehicle for delivering federal employment policy into the twenty-first century. The law in this area should be modernized and streamlined: there is no need for every federal employment and labor statute to have its own definition of employee. We recommend that Congress adopt a single, coherent concept of employee and apply it across the board in employment and labor law.⁴

The employment relationship can be manifested in a variety of circumstances. Most often, the law of agency governs it. The **Restatement (Second) of Agency** §220 defines the term *servant* as “a person employed to perform services in the affairs of another and

who, with respect to the physical conduct in the performance of the services, is subject to the other's control or right to control." It lists ten factors to assist in distinguishing between workers as employees and as independent contractors:

- the extent of control which, by the agreement, the master may exercise over the details of the work;
- whether or not the one employed is engaged in a distinct occupation or business;
- the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;
- the skill required in the particular occupation;
- whether the employer or the workman supplies the instrumentalities, the tools, and the place of work for the person doing the work;
- the length of time for which the person is employed;
- the method of payment, whether by the time or by the job;
- whether or not the work is part of the regular business of the employer;
- whether or not the parties believe they are creating the relation of master and servant; and
- whether the principal is or is not in business.

These factors are considered by courts and administrative agencies in determining whether an employment relationship exists.

In its holding in *Community for Creative Non-Violence v. Reid*,⁵ the Supreme Court interpreted the term **employee** under federal copyright law to determine if a work was prepared by an employee or an independent contractor. In *Reid*, the Supreme Court construed the term **employee** to incorporate the general common law of agency rather than the law of any particular state. In so doing, it set forth a test, incorporating the **Restatement** definition of "**employee**," for determining who qualifies as an "**employee**" under the common law:

In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are 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; and the tax treatment of the hired party. . . .

While establishing that all of these factors are relevant and that "no one of these factors is determinative. . . ."⁶

Employee Status Under Common Law

Respondeat Superior

The legal doctrine imposing liability on an employer for the acts and omissions of an employee.

In the employer–employee or employment relationship, the principal or employer has the right to control the physical conduct and activities of the **employee**. According to the long-standing common-law doctrine of *respondeat superior*, an employer is liable to

third parties for the foreseeable negligent acts and omissions committed by an **employee** in the course and scope of employment.⁷

Common-Law Test

Under the federal retirement and benefits law known as the Employee Retirement Income Security Act (ERISA), the U.S. Supreme Court has endorsed the **common-law test**. That test requires courts to consider “the hiring party’s right to control the manner and means by which the product is accomplished” (*Nationwide Mutual Ins. Co. v. Darden*, 503 U.S. 318, 323-24 (1992)). In that decision, the Supreme Court held that “traditional agency law criteria” to control the work should guide courts in determining who was an **employee** for purposes of applying federal pension law. However, Justice Souter’s opinion for the unanimous Court stated “[w]e have often been asked to construe the meaning of ‘employee’ where the statute containing the term does not helpfully define it.” He stated that the federal pension law definition of *employee* as “any individual employed by an employer” is completely circular. The Court summarized its **common-law** definition of **employee**, adopted in an earlier case, as follows:

In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party’s right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are 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.⁸

IRS 20-Factor Test

Interestingly, the Internal Revenue Code does not define “**employee**.” The IRS has issued a set of guidelines generally referred to as the **20-Factor Test**. The IRS test is termed the “**right to control**” test, because each factor was designed to evaluate how work is performed. Under IRS rules and **common law** principles, **independent contractors** control the manner and means by which contracted services, goods, or results are achieved. The more control a business exercises over the manner and means of work performance, the more likely the workers will be classified as **employees**. A worker does not have to meet all **20 factors** to qualify as an **employee** or **independent contractor**, and no single factor is determinative of a worker’s status. Issued as **Revenue Ruling 87-41**, the **20 factors** considered by the IRS are:

1. **Instructions.** Level of instruction given by company to the worker is a strong indicator of status.
2. **Training.** Amount of training requested or required of the worker by the company can indicate status. Independent contractors do not need additional training.
3. **Integration.** Degree of business integration of the worker’s services into the company’s operations is considered.

Common-Law Test

A test to determine employment status that focuses on the hiring principal’s right to control the manner and means by which the worker pursues the work result to be accomplished.

4. **Services personally performed.** Extent of personal services required by the company to be performed by particular workers is evaluated.
5. **Assistants.** Control by a company of assistants utilized by the worker with respect to their hiring, supervision, and compensation indicates an employment relationship.
6. **Continuing relationship.** Continuity of the relationship between the company and a worker will indicate the permanence as employment of the relationship.
7. **Hours of work.** The worker's ability to determine his or her work schedule will indicate status. Companies may require contractors to observe certain work hours for legitimate business reasons.
8. **Full-time status.** The company's demand of full-time work from a worker indicates an employment relationship.
9. **Job location.** Requiring a worker to provide services on-site at company premises suggests an employment relationship.
10. **Order of work.** The company's insistence that a worker follow a specific sequencing of work indicates his or her status as an employee.
11. **Reports.** Requirements that workers provide regular reports to the company suggest an employment rather than a contractor relationship.
12. **Method of payment.** Methods of payment indicate status when workers are paid for results obtained (as for contractors) or for time or effort expended (as for employees).
13. **Payment of expenses.** Independent contractors normally bear the costs of their business and travel expenses.
14. **Provision of tools and materials.** Workers who perform most of their work using company-provided equipment, tools, and materials are more likely to be considered employees.
15. **Investment in facilities.** Independent contractors typically invest in and maintain their own work facilities. In contrast, employees rely on their employers to provide the work facilities.
16. **Realization of profit or loss.** Workers who receive predetermined earnings and have little chance to realize significant profit or loss through their work generally are classified as employees.
17. **Work for multiple companies.** Workers who simultaneously provide services for several unrelated companies are likely to qualify as independent contractors.
18. **Availability to public.** Workers regularly making their services available to the general public are, for the most part, considered independent contractors.
19. **Control over discharge.** A company's unilateral right to discharge a worker suggests an employment relationship. A company's ability to terminate relationships with independent contractors generally depends on the contract terms.
20. **Right to quit.** Most employees can unilaterally terminate their work for a company without liability. Independent contractors cannot terminate services without liability, except as permitted by their contracts.

While the IRS has not formally repealed this test, it has recentered its analysis, beginning in 1997, with the issuance of the following guidelines for its field auditors' use in determining worker classifications. The IRS Training Manual identifies three primary categories of evidence and the facts most commonly evaluated.⁹ When considering whether an individual is an **employee** or acts in the capacity of an

independent contractor, the IRS considers three categories of behavior. These guidelines also aid courts and administrative agencies in worker classification; they are:

- **Behavioral control**
- **Financial control**
- **Elements of the relationship**

With regard to **behavioral control**, the IRS will consider whether the business has the right to **direct and control** how the work is performed through instructions, training, or other means of direction. In addition, in a lawsuit the court will determine if the employer directs the person as to where, how, and when to perform the work. Requiring the wearing of common uniforms, mandating how the work is to be performed, and supplying the requirements to perform the work, including work spaces, tools, and supplies, are considerations examined by courts in determining whether the worker is an **employee** or **independent contractor**. Finally, the higher the degree of skill or the licensing or certification required for a position, the more likely it is that a worker in the position will be accorded **independent contractor** rather than **employee** status. In the area of **financial control**, the IRS reviews the facts showing the employer's **right to control** the business aspects of the worker's position. In its review, the court will consider whether business expenses are reimbursed, whether the worker has a significant personal investment in the business, and whether the worker supplies tools, licenses, and vehicles. More importantly, the extent to which the worker makes his or her services available to the general market is reviewed, including whether the worker is engaged by other persons, advertises services, and maintains business licenses and insurances. The manner and form of compensation are analyzed for commonality with typical employment terms. Finally, the extent to which the worker can realize a profit or loss is reviewed, since **employees** do not, and **independent contractors** do, bear such opportunity or risk. IRS auditors also consider the **elements of the worker-employer relationship**, and to do so they review the written contracts describing the relationship the parties intended to create. Fringe benefits, for example, are extended to **employees** but not to those considered to be **independent contractors**. Lastly, auditors consider the permanency of the relationship.

Cumulatively, these factors have become known as the “**direct and control**” test. This test advances a public policy of assuring that someone is responsible for the potential harm and damage workers might cause. The test satisfies that policy because employers can control the workplace environment. Employers can mitigate risk by procuring insurance and through risk-shifting indemnification agreements with third parties.

Even those workers who can be classified as **independent contractors** under the common-law rules may nevertheless be treated as **employees** by statute (i.e., a **statutory employee**) for certain employment tax purposes. They will be deemed statutory employees if they fall within one of four categories meeting the three conditions set forth under federal Social Security and Medicare tax law. These categories are (1) drivers who distribute produce or pick up laundry or dry cleaning, if the driver is an agent of the business or paid on commission; (2) full-time life insurance salespersons who work for one life insurance company; (3) work-at-home individuals who work on goods or materials supplied by another that must be returned to the supplier of those goods and who must follow furnished specifications; and (4) full-time traveling salespersons who turn in orders from wholesalers, retailers, and contractors.

Federal Law “Economic Realities” Test

Under the “**economic realities**” test, the issue is whether the worker is economically dependent on the business to which the services are rendered or is effectively in business for himself or herself. Generally, courts apply this test only when determining whether workers are **independent contractors** or **employees** under a statute designed to protect or benefit **employees** (such as a minimum wage or workers’ compensation statute) and the statute does not require that the determination be made under only **common-law** factors. The Fair Labor Standards Act (FLSA) sets forth the federal wage and hour requirements imposed on employers. The act contains the same definition as that used in ERISA, namely, “any individual employed by an employer,” which is vague, at best. However, the FLSA defines the term *employ* to mean “suffer or permit work.” The Supreme Court in its *Nationwide* decision held that the employment relationship extends to those recognized under the **common-law test** under a test known as the “**economic realities**” test. For purposes of wage and hour laws, an individual’s status is determined using six factors:

1. which party has the right to control the means and manner of production;
2. the worker’s opportunity for realizing profit or loss based on his or her own performance and management;
3. which party supplies the equipment or materials used to accomplish the task;
4. the degree of skill required;
5. the permanence of the relationship; and
6. whether the job being performed is integral to the company’s business.

Many state court decisions follow this multifactor analysis in difficult cases when determining **employee** status for purposes of employee protection laws, such as workers’ compensation benefit laws. In each situation, the employer should determine the statutory purpose of the law at issue; for example, the definition of **employee** under workers’ compensation statutes is different from that under other statutes. The workers’ compensation statutes cover a broad spectrum of workers. One commentator has stated “[t]he modern tendency is to find employment when the work being done is an integral part of the regular business of the employer, and when the worker, relative to the employer, does not furnish an independent business or professional service.”¹⁰ The careful employer must consult the laws of each state. For example, in its *S.G. Borello & Sons v. Dept. of Industrial Relations* decision, the California Supreme Court held that the “**common law**” test is merely “useful” when determining **employee** status under that state’s workers’ compensation statute.¹¹ The court held that the **economic-realities** test was more meaningful and promoted the remedial purpose of the state’s workers’ compensation statute. The court further suggested that the **economic-realities** test should be utilized in determining **employee** status under California antidiscrimination and other employment-related statutes.

Economic-Realities Test

A test to determine a worker’s status in which the worker’s activities are viewed in the context of a statute designed to protect or benefit employees.

Employee Status Under Federal Labor Law

The National Labor Relations Act (NLRA) was enacted in 1935 to protect the rights of **employees** and employers, to promote collective bargaining, and to declare unlawful

certain prior practices of both management and labor. Responding to an earlier decision of the Supreme Court, Congress amended the act to exclude **independent contractors**, **supervisors**, and **managers** from its coverage. In response to the amendment, the National Labor Relations Board (NLRB), the administrative agency responsible for enforcing the act, adopted the “**direct and control**” test to determine **employee** status.

Supervisors under the NLRA are defined as:

[A]ny individual having authority, in the interest of the employer, to hire, transfer, suspend, lay off, recall, promote, discharge, assign, reward, or discipline other employees, or responsibility to direct them, or to adjust their grievances, or effectively to recommend such action, if in connection with the foregoing the exercise of such authority is not of a merely routine or clerical nature, but requires the use of independent judgment.¹²

Managerial employees are defined under the NLRA as those who “formulate and effectuate management policies by expressing and making operative the decisions of the employer.”¹³ The law has created considerable debate with regard to a number of recent court decisions. With respect to the managerial exception from **employee** status under the NLRA, the Supreme Court has held that full-time faculty members at a large private university were “managerial” employees since the “faculty’s professional interests—as applied to governance at a university—cannot be separated from those of the institution . . . The ‘business’ of a university is education.”¹⁴ In *NLRB v. Health Care & Retirement Corp.*,¹⁵ the Court held that licensed practical nurses who directed lesser skilled **employees** were **supervisors** under the act. The Court concluded that the nurses’ professional interests in caring for patients were not distinct from that of the nursing home as employer. In *NLRB v. Kentucky River Community Care, Inc.*¹⁶ the Supreme Court found that the NLRB had improperly concluded that registered nurses were not within the statutory definition of supervisors. In response to that criticism, the NLRB articulated a new standard for supervisorial responsibility:

Where an individual is engaged a part of the time as a supervisor and the rest of the time as a unit employee, the legal standard for a supervisory determination is whether the individual spends a regular and substantial portion of his/her work time performing supervisory functions. Under the Board’s standard, “regular” means according to a pattern or schedule, as opposed to sporadic substitution. The Board has not adopted a strict numerical definition of substantiality and has found supervisory status where the individuals have served in a supervisory role for at least 10-15 percent of their total work time.¹⁷

Managerial Employee

A person who formulates and applies corporate policies to subordinate workers.

Proposed Restatement Definition

A significant development has recently occurred relative to defining employment and distinguishing it from other types of relationships. The American Law Institute (ALI), composed of judges, law professors, and practicing lawyers, has issued a proposed **Restatement of the Law (Third) Employment Law**. It is the ALI’s intention that its work, when completed, will provide the much-needed guidance, applicable nationwide, for legislatures and courts attempting to define the classes of individuals to be treated as employees, to identify workers protected from employment torts, and to state the duties imposed upon employers and employees. The ALI definition is as follows:

§1.01 of the Restatement of the Law Third Employment Law (proposed)

General Conditions for Existence of Employment Relationship

(1) Unless otherwise provided by law or by §1.02 [relating to volunteers] or §1.03 [relating to those individuals who through an ownership interest control all or a part of a business], an individual renders services as an employee of an employer if:

- (a) the individual acts, at least in part, to serve the interests of the employer,
- (b) the employer consents to receive the individual's services, and
- (c) the employer precludes the individual from rendering the services as part of an independent business.

This definition is based upon the judicial decisions interpreting the tests discussed above. The ALI notes that:

[t]he U.S. Supreme Court in a number of cases has ruled that where the statutory language does not provide meaningful guidance, Congress is presumed to have intended the “common-law” test to apply.

The common-law right to control test was originally developed not to provide a comprehensive definition of employee status, but, rather, to address the distinct question of when it is appropriate to hold a principal liable in *respondeat superior* for the torts of its agent. Under the test, the principal normally was vicariously liable only for the actions of those agents whose work the principal retained the “right to control.” A principal that retained the right to control the manner and means by which the work was performed was termed an “employer” and the agent in question an “employee.” Absent such control, the imposition of vicarious liability is normally considered inappropriate.

In the following case, a court considered whether an eight-year-old boy was held to be an employee of an oil company because he was paid a few dollars an hour when he did odd jobs at a gas station. When he slipped and hurt his hand, he tried to sue the oil company for negligence.

CASE 1.1

COURT JURISDICTION CAN BE LACKING WHEN A STATUTE
LIMITS A WORKER'S REMEDIES

LEMMERMAN V. A.T. WILLIAMS OIL CO.

350 S.E.2d 83 (1986)

Supreme Court of North Carolina

Facts. The mother of Shane Tucker, aged eight, brought him to work with her as a cashier at service station–convenience store because she lacked childcare.

While he was there, Shane would perform odd jobs, for which the store manager paid him. He slipped on the sidewalk on the property, fell, and cut his hand. He and his mother sued the oil company that operated the premises. They argued that Shane's injuries were caused by the company's negligence. Lemmerman was appointed *guardian ad litem* for purposes of bringing the lawsuit for Shane. In its defense, the company alleged that Shane was its employee and that his sole remedy was to file a claim under the state's workers' compensation act. In response to a motion, the trial court dismissed the lawsuit for lack of subject-matter jurisdiction. The court of appeals affirmed the trial court's ruling. Lemmerman appealed to the state supreme court.

Issue. Does a court have the power to hear a dispute when a statute specifically provides for a non-court remedy?

Language of the Court. Frye, J.: Plaintiff Shane testified at his deposition that he routinely accompanied his mother to her job as part-time cashier at defendant's store and service station. . . . According to his description, he ordinarily did his homework, ate a snack, and performed odd jobs about the station. These jobs consisted of picking up trash in the store, taking out the garbage, and stocking cigarettes and drinks. He had been doing these jobs for almost a month at the time of the accident. The child said that the jobs generally took him between half an hour and one hour to complete. In return, the store manager . . . would pay him a dollar, and occasionally more depending on the amount of work he had done. A fair reading of the child's testimony discloses that he clearly expected to be paid for his efforts.

We believe that this evidence amply supports the trial judge's findings that [the manager] who had the authority to hire and fire employees, hired the minor plaintiff to do odd jobs as needed in defendant's service station/convenience store business. Specifically, these tasks included stocking cigarettes and drinks and picking up trash. At the time of the accident, Shane was engaged in doing these tasks.

We also agree with the trial judge's conclusion that plaintiff Shane was defendant's employee at the time of the accident. . . . This Court has previously defined an employee as follows: "An employee is one who works for another for wages or salary, and the right to demand pay for his services from his employer would seem to be essential to his right to receive compensation under the Workmen's Compensation Act. . . ." (Citation omitted.)

The trial judge found that [the manager] had hired the child, that he had authority to hire and fire employees for defendant, and that the jobs Shane did were in the course of defendant's business and that he was engaged in doing them when he fell. We believe these facts, taken together, will support the conclusion that the plaintiff Shane was an employee of defendant at the time of the accident.

Decision. No. A court must refrain from exercising jurisdiction when a worker's status is that of an employee. On the job injury claims must be determined under the workers' compensation system and not by a lawsuit heard in court.

CASE QUESTIONS

Critical Legal Thinking. On appeal, it was argued that Shane was performing the services gratuitously. Did the fact that he was paid defeat that contention? Would Shane have a claim for the employer's failure to pay in accordance with wage and hour laws?

Business Ethics. Does this decision permit the company to profit from its own illegal act of employing a minor?

Contemporary Business. Should the court have considered the employer's violation of North Carolina child-labor statutes? Can you think of any other circumstances that should have caused the court to recognize jurisdiction to decide Shane's case?

The Worker as Independent Contractor

An **independent contractor** is *not* an **employee** of any employer. The individual is an independent businessperson who contracts with others to sell goods and services to them. He or she is retained to achieve a specific objective and exercises discretion to control the means and methods of performing the objective of the contract. Businesses report their payments to an **independent contractor** on IRS Form 1099 and do not withhold taxes from the payments or provide any benefits to the workers employed by the **independent contractor**.

Unlike the principal-agency relationship, which is the essence of an employer-employee relationship, the relationship of **independent contractor** to principal creates different liabilities for the parties. An **independent contractor** is any person or party who works for another under conditions that are not sufficient to create control by the principal. Except for the expected product or result, the **independent contractor** is free to exercise discretion in how the work is to be performed. As stated in the above section on defining **employee** status, there is no absolute rule or formula for determining whether a person is an **independent contractor** or an **employee**.

Distinguishing **employees** from **independent contractors** focuses on the principal's **right to control** the "physical conduct" of **employees** and readily applies to the context of imposing tort liability upon the doctrine of *respondeat superior*. Business liability is predicated upon the principal's ability to control the circumstances that might lead to tort liability. These circumstances are ones that the principal usually creates, manages, or insures against risk of harm. Since the principal retains the benefits of the workers' labor, it is only fair that such additional burdens be placed upon the employer. Case law establishes that the courts undertake a practical, fairness-based approach to determining worker status. If the principal lacks the **right to control** all

the physical details of the work, an employment relationship may still exist if the other factors indicate that the worker is not operating an independent business. For example, unskilled workers who provide only their own labor ordinarily will not be held to be providing services as an **independent contractor**, regardless of whether an employer has abdicated a degree of control over the details of the work. The modern trend of American law requires that the worker have the entrepreneurial discretion to operate an independent business, including the substantial investment in property to operate the business and the ability to employ others.



Concept Summary

Independent Contractor Terminology

The following terms have these meanings within the law of independent contractor relationships:

- **Contractor** An individual (also known as an **independent contractor**) who contracts to perform work for a principal. Not required to follow instructions from the principal on how to perform services.
- **Company** A general term describing an entity for which the work is performed. By itself, the term does not determine whether its workers are employees or independent contractors.
- **Employee** A worker who is deemed by law to be in an employment relationship with a business employer.
- **Employer** A business that is deemed by law to be in an employment relationship with an employee.
- **Principal** A party or business that has contracted for the services of an independent contractor.
- **Worker** A person who performs services for another. By itself, the term does not determine whether the worker is an employee or an independent contractor.

The case law determining **independent contractor** status has continued its inquiry beyond merely the **right to control** the physical details of the work. Courts look to whether the worker's services were part of an independent business or were integrated into the principal's business. They also look to the nature of the work and the industry involved.

Example: Victoria Lis Alberty-Velez sued a Puerto Rican television station for pregnancy and gender discrimination. She had worked for many years as a host of various programs. The show's producer set the location and hours of filming and established the basic content of the program. The station provided the lights, camera, and makeup. Alberty-Velez was responsible for providing her clothing and hair styling and was paid a flat sum per episode. No income taxes or social security taxes were deducted from her check, and she was not provided fringe benefits, such as health insurance. A federal court applied the common-law test of determining employee status. In concluding that Alberty-Velez was an independent contractor, the court considered, among other facts, the following: as a television actress Alberty-Velez occupied a skilled position requiring talent and training not available on the

job; she provided her clothing and image-related supplies necessary for her appearance; she was not assigned any work other than that of a particular program; and she was paid a flat fee per episode. She could not successfully argue that the station sufficiently controlled her work. The court held that the situation must be considered in light of the work performed and the industry involved.¹⁸



Workplace Application

Independent Contractor Status

Before deciding to retain a worker as an **employee** or an **independent contractor**, the employer should carefully consider the purpose and nature of the work relationship.

Independent Contractor Advantages

An employer does *not* pay the following on behalf of the **independent contractor**:

- federal unemployment tax (F.U.T.A. and I.R.C. §3301)
- Social Security tax (F.I.C.A. and I.R.C. §3111)
- state and local taxes
- workers' compensation costs
- fringe benefits, such as medical insurance, vacations, and retirement plans

The employer's legal exposure to the following is reduced in independent contractor arrangements:

- threats of unionization (NLRA)
- requirements to pay workers in accord with federal wage laws (FLSA)
- laws regulating discrimination against **employees**
- wrongful termination claims of workers

- contracts of the **independent contractor** relating to the work to be performed
- torts (harm caused by wrongful conduct) of the **independent contractor** (i.e., the employer is not vicariously liable for the acts of the **independent contractor**)

These administrative burdens on the employer are reduced or eliminated:

- costs of maintaining human resource and payroll functions eliminated
- record keeping obligations reduced
- direct supervision of workers' costs reduced

Independent Contractor Disadvantages

A business suffers the following when using an independent contractor:

- loss of control (the employer cannot dictate how the work is performed)
- the contract between the business and the worker controls the terms applicable to terminating the relationship
- loss/disruption of morale and continuity within the workforce

Business Liability for Reclassification of the Worker as an Employee

The burden is on the employer to establish that the worker is not an **employee**. Sympathetic courts and administrative agencies frequently reclassify workers as **employees**. If the employer misclassifies the worker as an **independent contractor**, ruinous financial consequences can occur. They can include the following for workers subsequently reclassified:

- The employer must pay both the employer's and the employee's portion of all payroll taxes for a retroactive three-year period.
- The taxing authorities will estimate income withholding should have been on all compensation paid to the reclassified workers for a retroactive three-year period.
- Penalties and interest will be due and payable for:
 - All federal and state payroll taxes that should have been paid;
 - The employer's failure to pay state and federal unemployment taxes;
 - Failure to file proper tax returns; and
 - Failure to pay, file, and deposit payroll tax payments due federal and state tax authorities.
- Personal liability will be imposed on corporate officers and other responsible persons for 100 percent of the total withholding taxes not paid.¹⁹

The IRS may assess payroll taxes until three years after the date of the tax return for the year in question. In cases of fraud in the classification of **employees**, if the employer failed to file a payroll tax return, the period in which the IRS can pursue the employer is unlimited. Other statutes will govern state tax authorities.

In addition to these tax matters, the reclassification of the worker to **employee** status will subject the employer to the following:

- workers may make retroactive claims that they were not paid in accordance minimum wage and overtime requirements under federal and state laws and local ordinances;
- the business will have to pay penalty assessments for its failure to obtain workers' compensation as required under state law;
- the employer's pension and other benefit plans may be disqualified if the reclassification of **independent contractors** to **employee** status reduces the number of participating **employees** below the requirements of federal pension and welfare benefit law;²⁰
- penalties may be imposed on the employer for not properly classifying the worker for purposes of federal immigration law; and
- the employer may be exposed to liability for damages from failing to give proper notice when closing a worksite or plant as required under federal and state mass layoff laws.

One of the more interesting cases to consider, whether workers are **employees** or **independent contractors**, is provided by the Federal Communications Commission's imposition of a fine against the CBS television network relating to the broadcast of a Super Bowl halftime show.

CASE 1.2

DETERMINING EMPLOYEE STATUS REQUIRES
A WEIGHING OF FACTORS

CBS CORPORATION, ET AL. V. F.C.C.

535 F.3d 167 (3rd Cir. 2008)

U.S. Court of Appeals for the Third Circuit

Facts. On February 1, 2004, CBS presented a live broadcast of the National Football League's Super Bowl XXXVIII. Nearly 90 million viewers watched the halftime show during which Janet Jackson and Justin Timberlake had an alleged "wardrobe malfunction." Janet Jackson was the announced headliner, and Justin Timberlake was a "surprise guest" for the final minutes of the show. He was unveiled on stage during the conclusion of the show. He and Jackson performed his popular song "Rock Your Body" as the show's finale.

Following the broadcast the Federal Communications Commission fined the network \$550,000 because it contended the performance violated broadcast decency standards. The FCC objected to sexually suggestive choreography, which portrayed Timberlake seeking to dance with Jackson, and Jackson alternating between accepting and rejecting his advances. The performance ended with Timberlake singing, "gonna have you naked by the end of this song," and simultaneously tearing away part of Jackson's bustier. CBS had implemented a five-second audio delay to guard against the possibility of indecent language being transmitted on air, but it did not employ similar precautionary technology for video images. As a result, Jackson's bare right breast was exposed on camera for nine-sixteenths of one second.

CBS issued a public statement of apology for the incident. CBS stated Jackson and Timberlake's wardrobe stunt was unscripted and unauthorized, claiming it had no advance notice of any plan by the performers to deviate from the script. CBS appealed the fine to the federal court of appeals on many grounds. Among them was its contention that it was not liable for their actions because they were independent contractors and not network employees.

Issue. Whether or not Janet Jackson and Justin Timberlake were CBS employees at the time the network broadcast “indecent” material during the 2004 Super Bowl halftime show.

Language of the Court. Scirica, C.J. . . . The parties dispute whether the conduct giving rise to liability was performed by CBS’s employees. CBS asserts, and the FCC denies, that Jackson and Timberlake were independent contractors and therefore outside the scope of respondeat superior.

. . . [The Supreme Court decision in] Reid did not provide guidance on the relative weight each factor should be assigned when performing a balancing analysis. But the Court has indicated that determining the appropriate balance is a case-specific endeavor: There are innumerable situations which arise in the common law where it is difficult to say whether a particular individual is an employee or an independent contractor. . . . In such a situation . . . there is no shorthand formula or magic phrase that can be applied to find the answer, but all of the incidents of the relationship must be assessed and weighed with no one factor being decisive. What is important is that the total factual context is assessed in light of the pertinent common-law agency principles . . . under the common law, respondeat superior is limited to the employer-employee relationship.

Accordingly, all of the Reid factors are relevant, and no one factor is decisive, but the weight each factor should be accorded depends on the context of the case. . . . [R]ather than balancing those factors it did consider, the Commission focused almost exclusively on CBS’s right of control over the performers. . . . But it is undisputed that CBS’s actual control over the Halftime Show performances did not extend to all aspects of the performers’ work. The performers, not CBS, provided their own choreography and retained substantial latitude to develop the visual performances that would accompany their song. . . . [T]he performers retained discretion to make those choices in the first instance and provided some of their own materials.

It is undisputed that both Jackson and Timberlake were hired for brief, one-time performances; CBS could not assign more work to [them]. Second, Jackson and Timberlake selected and hired their own choreographers, backup dancers, and other assistants without any involvement on the part of CBS. Third, Jackson and Timberlake were compensated by onetime, lump-sum contractual payments and “promotional considerations” rather than by salaries or other similar forms of remittances, without the provision of employee benefits. Fourth, the skill required of a performer hired to sing and dance as the headlining act for the Halftime Show — a performance during a Super Bowl broadcast, as the FCC notes, that attracted nearly 90 million viewers and was the highest-rated show during the 2003-04 television season — is substantial even relative to the job of a general entertainer, which is itself a skilled occupation.

Also weighing heavily in favor of Jackson and Timberlake’s status as independent contractors is CBS’s assertion in its briefs, which the FCC does not refute, that it paid no employment tax. Had the performers been employees

rather than independent contractors, federal law would have required CBS to pay such taxes. . . . The FICA tax scheme . . . requires employers to share the FICA tax liabilities of their employees but not of their independent contractors. Finally, there is no evidence that Jackson, Timberlake, or CBS considered their contractual relationships to be those of employer-employee. . . . On balance, the relevant factors here weigh heavily in favor of a determination that Jackson and Timberlake were independent contractors rather than employees of CBS.

Decision. No. The performers were independent contractors who acted for a limited purpose for one isolated, brief program and *respondeat superior* does not apply.

CASE QUESTIONS

Critical Legal Thinking. If CBS had been more involved in the production of the performance would the decision have been different? What factors would be significant in holding Jackson and Timberlake to be employees of CBS?

Business Ethics. Does the court's holding make it easier for companies to escape liability for their workers' misbehavior?

Contemporary Business. Can you think of other circumstances where entertainers have created liability for injuries to third parties on the part of a production company or performing venue?



Concept Summary Common Tests for Employee Status

Purpose	Test
Income taxes	IRS 20-Factor Test, common law
Fair Labor Standards Act (FLSA)	Economic realities
National Labor Relations Act (NLRA)	Common law
Employment discrimination	Common law and economic realities (federal court circuits are split)
Employee Retirement Income Security Act (ERISA)	Common law, IRS 20-Factor Test
Social Security/Medicare taxes	Common law
Other purposes	Use common law unless definition of employee in the statute is more expansive so as to include those who might not qualify as an employee under the common-law test (<i>Nationwide Mutual Ins. Co. v. Darden</i> , 503 U.S. 318 (1992)).

The IRS also recognizes two categories of **statutory nonemployees**. They are direct sellers and licensed real estate agents. They are treated as self-employed for all federal tax purposes if substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked; and if their services are performed under a written contract that they will not be treated as employees for federal tax purposes.

The Worker as Leased Employee

The **leased employee** relationship is slightly different from those previously discussed in this chapter. This person is a type of contingent worker. Employee leasing is a contractual arrangement in which a third-party business (also known as a **professional employer organization (PEO)**) “employs” the staff of the business and undertakes all of the administrative functions of the employer, including payroll reporting and providing fringe benefits. A fee plus cost reimbursement is paid to the leasing company. By aggregating the employees of several companies into one group, PEOs can offer better fringe benefits to the workers. The relationship between the PEO and its workers is an employment relationship.

A **leased employee** does not insulate the PEO’s client company from worker safety and employment discrimination laws. If the client company exhibits sufficient common law “**direct and control**” over the workers, then the **leased employees** will be considered **employees** for purposes of employment discrimination laws. In most cases, the client company will retain day-to-day supervision of the workers and will have some authority to hire and fire the workers of the PEO business. Another category of employee worker is the temporary worker, that is, someone assigned to work at a specific firm for a limited duration or for a specific project.

Some courts have applied the “**shared employee doctrine**” to **leased employee** relationships. In the event a worker is employed by two or more entities who may or may not have the **right to control** the specific activities of the shared employee, courts will often utilize the **economic-realities** test to determine if the employer–employee relationship exists. Some courts have found joint responsibility for the separate wrongful conduct or acts of the other employer. This can occur when the regular, dedicated staff already employed in a business is transferred to the PEO. The client company rather than the PEO has responsibility for the day-to-day supervision of the **leased employee**.

The **leased employee** may pose several additional problems for the business owner. **Leased employees** may qualify as participants under the pension, retirement, and health plans of the owner. The **common-law test** is applied for **leased employees** to qualify under those plans.²¹ Under the federal FLSA the concept of **joint employment liability** is well recognized, and the leasing employer and the client company will have joint liability for compliance with federal and state wage and hour laws. Under the workers’ compensation system of compensating injured workers, the worker may not directly sue the employer. If a court or administrative agency should hold that the worker is the employee of the leasing employer, then the leasing employer and the client company are not **joint employers**. That result would permit the injured **leased employee** to sue the client company for negligence. Moreover, under the NLRA, multiple business entities may constitute a “single employer” for various compliance

Leased Employee

A type of contingent worker lent to an employer by a third-party business. The third-party business is primarily responsible for the worker’s legal compliance.

purposes under federal labor law. Additionally, the client company may also face liability for unpaid payroll taxes and audits if it has not managed the relationship in accordance with the requirements of the law.

Outsourcing

Outsourcing is similar to **employee leasing**. **Outsourcing** occurs when a company subcontracts part of its business operations to another company. With **outsourcing**, an outside company manages an entire project or part of the business that the company formerly managed itself. The **outsourcing** company implements its own work procedures and manages and supervises the workforce for the third-party employer. Usually **outsourcing** does not result in establishing **joint-employer liability**. Examples of **outsourcing** include having another company manage the human resources or information technology (IT) departments. While the objective of outsourcing is cost reduction, customer service sometimes suffers. Most of us have encountered the frustrations of dealing with a telephone-based customer service function that has been outsourced to an overseas location.

Section 530 Safe Harbor

The Revenue Act of 1978²² provides a defense to a challenge of an employer's classification of its workers. Under this defense, known as the **Section 530 safe harbor**, a worker may be classified as an **independent contractor** if certain criteria are met. An **independent contractor** may qualify under this section of the Revenue Act if the company:

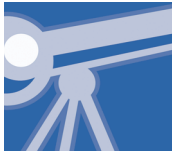
1. filed IRS Form 1099s for the independent contractors in a timely manner;
2. has not treated workers in substantially similar situations as employees; and
3. had a reasonable basis for treating the workers as independent contractors.

In the area of income taxation, employers report wages of employees to taxing authorities on a W-2 form. The employer form shows the deductions taken from income for payment of federal and state taxes and social security and other taxes. The IRS 1099 forms are issued by principles to independent contractors. On a 1099 form, the income earned will be stated, but no deductions will be made for income or other taxes. The income reports to the taxing authorities track independent contractors' earned income.

The employer's good-faith compliance with the law is considered in determining whether this **safe-harbor** defense will apply. The employer may rely on prior private-letter rulings the IRS has issued to the employer relating to worker classifications, case precedent, published rulings, regulations, and memoranda issued by the IRS. In addition, if the employer has been previously audited over the worker classification, and the audit did not result in assessments for payroll taxes for workers having similar positions

with the employer, then the employer can rely on the prior audit results. Long-standing, recognized practices regarding worker classification within a significant segment (more than 25 percent) of the employers in its industry will also aid the employer in arguing good-faith compliance with the law.

If the employer-taxpayer can establish the reasonableness of the worker's classification as an **independent contractor**, the burden of proving that the worker was an **employee** falls upon the IRS. In arguing the **safe-harbor** defense, the employer must have cooperated fully with the reasonable requests of the IRS.



Human Resource Form Independent Contractor Agreement

This Independent Contractor Agreement ("Agreement") is effective this _____ day of _____ by and between Corporation (hereinafter "Corporation") and _____, an individual (hereinafter "Consultant").

RECITALS

- A. Corporation is a software engineering company with a principal place of business in Richmond, Virginia;
- B. Consultant represents that he/she has the requisite experience, means, and methods to perform the requirements of this Agreement independent of Corporation; and,
- C. Corporation desires to appoint Consultant as its independent sales agent and Consultant desires to be appointed as an independent sales agent to Corporation.

NOW, THEREFORE, the parties agree as follows:

1. **Recitals.** The foregoing recitals are incorporated herein as if set forth in full.
2. **Scope of Services.** Consultant agrees to the best of his/her ability to provide an active and industrious sales effort in the solicitation of sales orders for Corporation's software products. In addition, Consultant agrees to perform such other services as may be agreed upon by the parties. Consultant shall render such reports and meet with Corporation representatives as may from time to time be reasonably required.
3. **Term.** This Agreement shall commence on the last day of _____, and continue for an initial term of two years, unless such term is terminated sooner pursuant to the provisions of this Agreement.
4. **Territory.** During the term of this Agreement, Consultant shall represent Corporation as an independent sales consultant for Corporation's software products in the states of Virginia, Maryland, and Delaware. Consultant shall devote such time, attention, and effort as he/she shall decide is necessary to perform the purposes of this Agreement. Consultant shall determine the method, details, and means of performing the services required of him/her. At his/her own expense, he/she may hire employees or other subcontractors to perform the sales efforts required of him/her.
5. **Compensation.** Corporation agrees to pay Consultant for the services and obligations set forth herein, the sums as are set forth in Corporation's sales commission schedule dated _____, which is incorporated herein as if set forth in full. Commissions shall be paid to Consultant thirty (30) days following Corporation's

receipt of payment in full for each customer order placed by Consultant with Corporation. Commissions payable shall be net of any customer discounts, rebates, allowances, refunds, or other credits granted to customer, shipping costs, returns received from prior Consultant orders, and sales taxes payable upon such transactions.

- 6. Consultant's status.** Consultant is not and shall not be deemed an employee of Corporation. Consultant shall not be eligible for any employee benefits adopted by Corporation from time to time. Consultant shall be responsible for the payment of his/her own costs and expenses incurred in connection with his/her performance hereunder, which costs shall not be reimbursable by Corporation. Consultant shall timely file and pay all required self-employment tax, withholding reports and estimates and shall furnish Corporation with copies or other evidence of prompt and timely filing and payment upon request.
- 7. Termination.** This Agreement shall terminate upon the earlier of: (a) the death or legal incapacity of Consultant; (b) the filing of any petition by Corporation under any chapter of the Bankruptcy Act, or other federal or state insolvency or bankruptcy act; (c) the filing of any petition against Corporation under any chapter of the Bankruptcy Act, or other federal or state insolvency or bankruptcy act if not dismissed within thirty (30) days; (d) the appointment of a receiver or trustee to take possession of all or substantially all of the assets of Corporation if not discharged within thirty (30) days; (e) a general assignment for the benefit of creditors of Corporation; or (f) the dissolution and winding up of the business of Corporation.
- 8. Nondisclosure of Information Concerning Business.** Consultant agrees he/she will not, directly or indirectly, divulge, disclose or communicate information concerning matters affecting or relating to the business of Corporation to any person at any time unless disclosure is required for, or of aid or advantageous to, the successful operations of Corporation or the performance of Consultant's duties. Without limiting the generality of the foregoing, Consultant shall not disclose the names of any of Corporation's customers, the prices Corporation obtains or has obtained, or for which it may sell or has sold its products or services, its manner of operation, its plans, its processes, or any other information about or concerning the business of Corporation. Without regard to whether any of the matters in this Paragraph would otherwise be deemed confidential, material, or important, the parties stipulate that as between them, the above are confidential, material, and important and gravely affect the conduct of the business of Corporation and its goodwill and any breach of the terms of this Paragraph would be a material breach of this Agreement.
- 9. Miscellaneous.** This Agreement shall not be amended, altered, or changed except by a written agreement signed by the parties hereto. If any provision of this Agreement is unenforceable or unlawful under any applicable law of any jurisdiction, in such jurisdiction the remainder of this Agreement's provisions shall be deemed fully enforceable in accordance with their terms. This Agreement contains the complete agreements or representations by, or between, the parties, written or oral, which may have related to the subject matter hereof in any way. The law of the State of Virginia shall govern all questions concerning the construction, validity, and interpretation of this Agreement, and performance of the obligations imposed by this Agreement. Should any litigation be commenced between the parties to this Agreement concerning any of the matters stated herein, the prevailing party shall be entitled to recover its reasonable attorney's fees and costs from the other party in such an action.

Corporation

By: _____
Its President

Consultant

By: _____
[Consultant's name]

Key Terms and Concepts

- Civil law
- Public law
- Statutes and ordinances
- Executive orders
- Substantive law
- Procedural law
- Administrative agencies
- Enabling statute
- Rules, regulations, and orders
- Common law
- Adversary system
- *Stare decisis*
- Precedent
- Adjudication
- Subject-matter jurisdiction
- Federal-question jurisdiction
- Diversity jurisdiction
- Preempt
- Employee
- Independent contractor
- Restatement (Second) of Agency
- Common-law test
- Direct and control
- 20-Factor Test
- Revenue Ruling 87-41
- Behavioral control
- Financial control
- Elements of the relationship
- Statutory employee
- Economic-realities test
- Supervisors
- Managerial employee
- *Respondeat superior*
- Statutory nonemployees
- Leased employee
- Professional Employer Organization
- Shared-employee doctrine
- Joint-employee liability
- Outsourcing
- Section 530 safe harbor

Chapter Summary

- The sources of employment law are varied. An employer must comply with federal and state laws and regulations, local ordinances, and its own policies and procedures. Employment is treated as an important opportunity to improve the individual and, consequently, bestow the benefits of work upon society. Our legal system, while complex, is intended to balance the benefits and burdens of the employment relationship.
- The federal Constitution requires that the laws of states and local municipal governments comply with the legal requirements issued by laws adopted by Congress, federal administrative agencies, and judicial decisions.
- The role of the judicial branch is to interpret the actions of the litigants relative to the applicable relevant legal principles involved in the dispute. In our system, only the judicial branch can declare whether some action is in accord with constitutional requirements, statutory requirements, or prior court decisions. Lower courts within a judicial system are required to follow the decisions on a subject of the highest court in that jurisdiction. This principle is known as *stare decisis*. It applies in all states except Louisiana, which follows both common law and civil law.
- Courts are divided into federal and state jurisdictional systems. Recourse to the courts may be

sought only in a manner consistent with the requirements established for them by the legislative branch of government.

- The classification of a worker as an employee or as an independent contractor has important legal and tax liability consequences for both the principal and the worker.

- Depending on the nature of the relationship between the business and the worker, the courts will employ various tests to classify a worker as either an employee or an independent contractor.

- Under the direct-and-control test, the hiring party has the right to control the manner and means by which the products of worker effort are achieved. The courts consider the degree of worker skill required to perform the work; who supplies the tools and equipment necessary to perform the work; the location of the work; the duration of the worker–employer relationship; and the worker’s freedom to accept or decline work assignments. In addition, the courts consider the degree to which the worker appears to maintain an independent business and is exposed to the risk of financial loss.

- Courts may also use three factors developed by the IRS to determine whether a worker is an employee: behavioral control, financial control, and the specific elements of the existing relationship. A former test (the 20-factor test) used by the IRS to determine employment status is not as well recognized today as it had been in the past.

- Under the federal law, the “economic realities” test is used to determine employee status for federal wage and hour and pension and benefit purposes. Under this test, the court will consider (1) which party has the right to control the means and manner of production; (2) the worker’s opportunity for realizing profit or loss based on his or her own performance and management; (3) which party supplies the equipment or materials used to accomplish the task; (4) the degree of skill required; (5) the permanence of the relationship; and (6) whether the job being performed is integral to the company’s business.

- The National Labor Relations Act (NLRA) excludes independent contractors, supervisors, and managers from its coverage. The National Labor Relations Board (NLRB) has adopted the common law direct-and-control test to determine employee status for purposes of federal union law.

- According to a definition proposed under the Restatement of the Law (Third) Employment Law, a worker will be classified as an employee if (a) the worker acts to serve the interests of the employer, (b) the employer receives those services, and (c) the employer precludes the individual from rendering the services as part of an independent business. This definition is among the most liberal and encompassing.

- Under the doctrine of *respondeat superior*, the employer is liable for the torts and contract liabilities of the worker. When working with independent contractors, the employer is not responsible for those torts and contracts. The independent contractor is liable for all taxes and fringe benefits that would otherwise be paid by an employer. The independent contractor is usually engaged in a separate business and assumes the risk of financial loss.

- Under the law, the employer is responsible for assuring that all taxes and contributions are made on its and the employee’s behalf. These include the payment of tax withholding, unemployment, social security taxes, and fringe benefit payments, such as health insurance premiums. The employer is responsible for any injuries suffered by the worker during the course and scope of his or her employment. The risk of reclassifying a worker from independent contractor to employee status can be expensive to the employer. The employer will be required to pay both the employer and employee portions of the outstanding payroll taxes, including any assessed penalties. In addition, the employer will be exposed to penalties related to pension and benefit plans.

- The leased employee relationship involves the use of a contingent worker. A third-party business, known as a professional employer organization (PEO), employs the staff of the business and

undertakes all administrative functions of the employer, including payroll reporting and provision of fringe benefits to the workers.

- Using outsourcing, companies subcontract part of their business operations to another company. The outside company manages an entire project or part of the business that the company formerly performed itself.

- The Internal Revenue Service (IRS) provides a safe-harbor provision excusing the misclassifying of workers as independent contractors when they should have been treated as employees. It requires that the employer file Form 1099s, that workers in substantially similar situations as the employees in

question were not treated differently, and that the employer had a reasonable basis for treating the workers as independent contractors.

- Many companies wish to employ independent contractors in lieu of employees because it shifts most legal responsibility for the acts and omissions of workers from the company to the independent contractor. However, the IRS will most often presume an employment relationship, leaving the company to shoulder more legal responsibility than it desires. To avoid the liabilities of an employment relationship, a company must follow strict, arm's-length treatment of contractors and deal with them much differently than they do employees.

Online Student Support

- Loislaw legal research and writing assignments.
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- Supplementary statutory and regulatory materials.

Case Problems

1.1 Sherrie Ann Adcok sued Chrysler Corporation for employment discrimination alleging that the company's refusal to award her a dealership was the result of sex discrimination. Under the dealership appointment agreement, the dealer (not Chrysler) controls the dealership and the day-to-day vehicle-selling operations. The dealer maintains discretion over dealership employment decisions and over the means and manner of advertising. The dealer (not Chrysler) owns the dealership, premises, equipment, and vehicles sold by the dealership.

Adcok argued that it was an employment relationship because Chrysler controlled the decisions about what cars could be purchased, retained approval of the appearance of the dealership, specified the dealer location, and required that certain financial requirements continued to be met. Chrysler had easy access to and use of the dealer's accounting information. In considering all of the factors that weigh both for and against an employment relationship, how should the court rule? (*Adcok v. Chrysler Corp.*, 166 F.3d 1290 (9th Cir. 1999))

1.2 John Weary served as a special agent to sell Northwestern Mutual life insurance products in Tennessee. A third party who had the authority to appoint sales agents to act on behalf of the life insurance company issued the agreement appointing Weary as an agent. The agreement stated that Weary was an independent contractor and was to be paid on a commission basis. After he failed to meet sales targets, Weary was terminated by the third party. Weary sued the life insurer for age discrimination in employment, arguing that he had been required to comply with rules and guidelines established by the insurer, although he admitted that he paid for his own equipment and worked out of his house. Which of the tests covered in this chapter should the court employ to determine whether Weary was an employee or an independent contractor to Northwestern Mutual? (*Weary v. Cochran*, 377 F.3d 522 (6th Cir. 2004))

1.3 A class-action lawsuit was filed by FedEx Ground Package System, suing FedEx for reimbursement for work-related expenses. The FedEx Ground Package System drivers contended they were employees and not independent contractors. When hired, they executed an agreement identifying themselves as independent contractors. Under that agreement, drivers provide their own trucks meeting the company's specifications, mark the truck with the FedEx logo, pay all costs of operating and maintaining the truck, and use the truck exclusively in the service of FedEx (or mask the logo if the truck is used for any other purpose). FedEx reserved the right to reassign the drivers or assign additional drivers in the driver's territory. The drivers agreed to have FedEx management employees travel with them four times each year to ensure they were meeting FedEx standards and to train with FedEx. The drivers could elect to have their truck operating costs paid by FedEx and deducted from their weekly "settlements." FedEx argued that the drivers enjoyed a "true entrepreneurial opportunity depending on how well the [drivers] perform[ed]." Who should prevail in this dispute? (*Estrada v. FedEx Ground Package Systems, Inc.*, 154 Cal. App. 4th 1 (2007))

1.4 Bridget O'Connor majored in social work at Marymount College in New York. As a component of her major, O'Connor was required during her senior year to perform volunteer fieldwork at one of several Marymount-approved social-service agencies. She was placed at a hospital for the mentally disabled. The internship was considered "work study" for financial aid purposes. It was an unpaid internship. While on assignment at the hospital, one of the licensed psychiatrists referred to O'Connor, in her presence, as "Miss Sexual Harassment"—a term he later explained was intended as a compliment, to convey the idea that she was physically attractive and, as such, was likely to be an object of sexual harassment. The doctor made other inappropriate sexual remarks, including suggesting that he and O'Connor should participate in an "orgy." O'Connor's complaints against the doctor were investigated, and O'Connor was reassigned to another facility, where she completed her internship hours. She filed suit against Marymount and the original facility, claiming sexual harassment. Marymount defended the suit on the grounds that O'Connor was not an employee. Which of the 20 common factors would you apply to determine whether Bridget O'Connor was entitled to relief? (*O'Connor v. Davis*, 126 F.3d 112 (2d Cir. 1997))

1.5 Twenty-six non-English-speaking adult garment workers who worked at a factory in New York's Chinatown sued their immediate employers and the Liberty Apparel Company. Liberty was a garment manufacturer that contracted out the last phase of its production process to the workers' employers. The workers contended that almost 75 percent of their time was spent working on Liberty jobs. Liberty employed people to monitor the assembly of its garments, but it disputed how much time it spent supervising the work. The workers sued under federal and state laws for the payment of the legally mandated minimum wage and the payment of overtime. How should the court analyze whether the defendants were joint employers of the workers? (*Zheng v. Liberty Apparel Co., Inc.*, 355 F.3d 61 (2d Cir. 2003))

End Notes

1. *Ochoa, et al. v. J.B. Martin and Sons Farms, Inc.*, 287 F.3d 1182 (9th Cir. 2002).
2. www.irs.gov/businesses/small/article/0,,id=99921,00.html.
3. *Black's Law Dictionary*, 8th ed. (Eagan, MN: Thomson West, 2004).
4. The Dunlop Commission on the Future of Worker-Management Relations — Final Report, pp. 65-66, issued to Secretary of Labor Robert B. Reich and Secretary of Commerce Ronald H. Brown (1994), http://digitalcommons.ilr.cornell.edu/key_workplace/2.
5. 490 U.S. 730 (1989).
6. 490 U.S. 730, 751-52.
7. Restatement (Third) of Agency §2.04.
8. 503 U.S. at 323-24 citing *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 750-51.
9. A copy of the manual may be downloaded at <http://www.irs.gov/pub/irs-utl/emporind.pdf>.
10. Larsen, *The Law of Workers Compensation*, §43.10 (1976).
11. 48 Cal. 3d 341 (1989).
12. 29 U.S.C. §152(11).
13. *NLRB v. Bell Aerospace Co. Div. of Textron, Inc.*, 416 U.S. 267, 288 (1974).
14. *NLRB v. Yeshiva University*, 444 U.S. 672 (1980).
15. 511 U.S. 571 (1994).
16. 532 U.S. 706 (2001).
17. *Oakwood Healthcare, Inc.*, 348 N.L.R.B. No. 37 (2006).
18. *Alberly-Velez v. Corporacion de Puerto Rico*, 361 F.3d 1 (1st Cir. 2004).
19. I.R.C. §6672.
20. I.R.C. §§401, 410.
21. *Burrey v. Pacific Gas & Elec. Co.*, 159 F.3d 388 (9th Cir. 1998).
22. Pub. L., 95-600, 92 Stat. 2885.