THE CONTINGENT WORK FORCE: PITFALLS AND PERILS

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I. THE CONTINGENT WORKFORCE: IS THE WORKPLACE REALLY “FISSURED”?

Employers in almost all industries use “contingent workers.” These workers are not employees of the “host” or “client” employer and fall into multiple categories: employees from a staffing agency or professional employer organization (“PEO”); employees of subcontractors; employees of a franchisee; and independent contractors.

The common characteristic of each type of contingent arrangement is that, at least nominally, a worker employed by one entity (or by the worker himself or herself) provides services to a second entity (often referred to as the “client employer”). If the worker is not properly paid, or is a victim of harassment or discrimination, is the client employer responsible?

A. Challenges from the Legislatures and Multiple Agencies

The growth of the contingent workforce has caused alarm among some regulators and academics, most notably Dr. David Weil, currently the head of the Wage and Hour Division of the United States Department of Labor (“DOL”). Dr. Weil, prior to becoming the head of the Wage and Hour Division (“WHD”), was a professor at Boston University. Similar concerns are shared by many legislators. An example is California Labor Code section 2810.3, effective as of January 1, 2015, which imposes liability on “client employers” for wage violations committed by their “labor contractors.” Another example is California Labor Code Section 226.8, enacted in 2011, which establishes substantial penalties for “willful misclassification of an individual as an independent contractor.” The National Labor Relations Board (“NLRB”), and particularly its current General Counsel, Richard Griffin, has also changed fundamentally the standard for finding that one employer is a “joint employer” or a “single employer” with another, in the context of franchisor/franchisee arrangements or contractor/subcontractor arrangements. Similar issues, and attacks on contingent employment relationships, have proliferated the California courts. In 2014, the California Supreme Court decided two extremely important decisions involving contingent workers, Ayala v. Antelope Valley Newspaper, 59 Cal. 4th 522 (2014), a case involving whether newspaper delivery personnel were employees or independent contractors, and Patterson v. Domino’s Pizza, LLC, 60 Cal. 4th 474 (2014), a 4-3 decision addressing whether a franchisor could be sued for the alleged sexual harassment of a franchisee employee by a franchisee supervisor. The California Supreme Court also currently has before it a case involving the definition of “employee” under the Industrial Welfare Commission’s (“IWC”) Wage Orders: a decision that may well define or at least focus the standard for joint employer liability for alleged wage violations.

B. Dr. Weil’s Theory of The “Fissured Workplace.”

Dr. Weil has popularized the term “the fissured workplace” in his academic and official writings.1 By using the pejorative term “fissured,” he reveals his inherent bias against any but

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1 It has been recently rumored that Dr. Weil intends to leave the WHD after the 2016 Presidential election to return to academia. Given the outcome of the 2016 election, it seems likely that Dr. Weil will indeed leave the DOL, but as of November 10 no announcement had been made concerning his departure.
the most traditional employment relationships.

In recent years the employment relationship between workers and businesses receiving the benefit of their labor has fissured apart as companies have contracted out or otherwise shed activities to be performed by other businesses. Often these secondary companies deepen the fissures, breaking those activities apart and shifting work even further out from the primary business...employees are often unaware for whom they actually work.

The blurred lines from the fissured workplace make achieving compliance with the wage and hour laws we enforce a difficult task. Intense competition between business models like subcontracting, temporary agencies, labor brokers, franchising, licensing and third party management leads to low pay, and non-compliance pulls down standards for all – making it difficult for responsible employers to survive in low margin, fiercely competitive conditions. The cost in this race to be the lowest bidder are borne by workers deprived of their wages and their rights.

Elsewhere, Dr. Weil has opined:

The incentive system of fissured employment creates a landscape that is sloped towards downward pressure on labor costs and non-compliance with basic statutes. Governing a workplace characterized by fissured employment requires a different approach to thinking about the structure of workplace laws and how they are administered...a fissured employment relationship requires first and foremost serious reconsideration of how we think about responsibility for workplace conditions.

Whether contingent work arrangements, “fissured” or not, actually create a “landscape that is sloped towards downward pressure on labor costs” is open to debate. Free market competition creates downward pressure on all manner of costs: labor costs and others.

C. How Big Is The Contingent Workforce?

Whether one views the contingent workforce as a good, bad or indifferent thing, there is no question that it is growing. A recent Government Accountability Office (“GAO”) study estimated that 7.9% of the employed labor force in 2010 was classified as “contingent workers.” The same study also acknowledged that, depending on how one defines a “contingent” worker, the actual percentage could be as small as 5% or as great as 33%. The GAO report stated that, “In general, contingent work is a term associated with those individuals who have temporary employment...In its broadest definitions, however, contingent work also refers to all individuals who maintain work arrangements without traditional employers or regular, full-time schedules – regardless of how long their jobs may last.”
The American Staffing Association, in an August, 2014 report, noted that the staffing and recruiting industry has been growing at a sustained, unprecedented rate, even though the overall labor participation rate has declined to the lowest level in decades. The American Staffing Association 2014 report also noted that the unemployment rate, as reported by the DOL, had dropped to the lowest level in six years; but that rate may be declining because fewer persons are actually in the labor force. Despite a declining labor force participation rate, the ASA report concluded that staffing employment has since 2009 been growing faster than the economy and faster than overall employment. Employment via staffing companies, according to the ASA report, averaged 3 million temporary and contract workers per week in 2013, up 4% from 2012. In contrast to the GAO report, the August 2014 ASA report estimated the staffing industry’s participation rate at approximately 2% as of July 2014.

D. Why Are Contingent Workers So Popular?

So why do businesses use contingent workers? The ASA conducted a study in 2014. Although the study was limited to staffing agency clients (i.e., it did not include franchisees or companies using independent contractors), 47% of the respondents identified the ability to assess a staffing agency employee, prior to hiring that person for the client’s workforce; 38% cited the ability to fill positions quickly; 32% cited the flexibility to change quickly the size of the workforce based on project loads.

E. Attacks on Multiple Fronts

Organized labor, whose market penetration has been declining for decades, is predictably hostile toward any non-traditional relationship. NLRB General Counsel Griffin is a former General Counsel to the International Union of Operating Engineers. He is also one of the former “recess appointees” to the National Labor Relations Board (“NLRB”), whose appointments by President Obama were found to be unconstitutional by a unanimous Supreme Court. General Counsel Griffin aggressively (and successfully) sought to convince the NLRB to abandon its 30-year old standard for determining whether two separate entities are “joint employers” under the National Labor Relations Act (“NLRA”). In *Browning-Ferris Industries of California, Inc.*, 362 NLRB No. 186 (2015), a divided NLRB ruled:

We will no longer require that a joint employer not only possess the authority to control employees' terms and conditions of employment, but also exercise that authority. Reserved authority to control terms and conditions of employment, even if not exercised, is clearly relevant to the joint-employment inquiry. As the Supreme Court has observed, the question is whether one statutory employer “possesse[s] sufficient control over the work of the employees to qualify as a joint employer with” another employer. Nor will we require that, to be relevant to the joint-employer inquiry, a statutory employer's control must be exercised directly and immediately. If otherwise sufficient, control exercised indirectly--such as through an intermediary--may establish joint-employer status.

Other agencies, legislatures and private litigants have mounted attacks on various non-traditional workforce relationships:
• The Equal Employment Opportunity Commission has, in an amicus brief, announced that it agrees with the NLRB’s *Browning-Ferris* decision, and would apply that test in cases under Title VII of the Civil Rights Act of 1964;

• Legislatures have considered and some have exacted, statues imposing liability on a “client employer” for labor violations by a labor contractor;

• Numerous agency and private litigators have been initiated against franchisors, seeking to hold the franchisor liable for conduct of a franchisee;

• Private and regulatory litigation has been initiated against “gig” economy arrangements, the most significant being the multiple challenges to the Uber and Lyft business models;

• Some jurisdictions have enacted ordinances purporting to grant collective bargaining or other rights to contingent workers on independent arbitrators;

• DOL has been particularly active; obtaining an agreement from the Subway organization to police the employment practices of its more than 26,000 franchisees and issuing two “Administrator’s Interpretations,” espousing, without compliance with the Administrative Procedures Act, its opinions concerning the standards to establish Joint employer status and the proper classification of independent contractors.

Regardless of whether or not one agrees with Dr. Weil or the NLRB, prudent employers must plan for the legal risks inherent in any contingent work arrangement. Those risks vary with the nature of the arrangement (i.e., staffing agency employees as opposed to independent contractors or a franchisor/franchisee relationship). The test for liability of the “client” employer can be different depending on the nature of the relationship and the type of claim asserted. In this paper we will attempt to address the most common situations and their risks.

**F. What Effect Will the 2016 Election Have?**

The election of Donald Trump could produce a significant change in the direction taken by federal regulatory agencies such as the DOL and NLRB. There are currently two vacancies on the NLRB and, eventually, the NLRB will have a 3-2 majority of Republican appointees. A new Secretary of Labor will be appointed and presumably so will a new head of the WHD. In general, we expect the appointees in the Trump administration to be far more friendly to employers than has been the case in the Obama Administration. Nevertheless, it may take considerable time to undo the decisions and initiatives of the Obama administration’s agencies. Developments at the state level, such as California Labor Code section 2810.3, will be unaffected by federal agency developments.
II. STAFFING AGENCIES

A. California Law Imposes Joint Employer Liability for Wage and Hour Violations of a “Labor Contractor” (California Labor Code § 2810.3 / AB 1897)

In response to a perceived need to hold employers accountable “for serious violations of workers’ rights, committed by their own labor suppliers, to workers on their premises,” as well as a perceived need to “incentivize the use of responsible contractors, rather than a race to the bottom,” the California Legislature enacted AB 1897 (codified as Labor Code § 2810.3) to impose significant new liabilities on private sector employers for violation of certain California labor laws committed by “labor contractors.”

Effective January 1, 2015, California Labor Code Section 2810.3 requires a “client employer” to share the obligation and liability with a “labor contractor” for “the payment of wages” to workers supplied by that labor contractor, as well as for securing valid workers’ compensation coverage for those workers. The statute does not apply when the workers provided are exempt from the payment of overtime compensation.

Section 2810.3 also prohibits a client employer from shifting to its labor contractor the legal obligation to maintain a safe workplace as required by Cal-OSHA. The term “client employer” is defined to include business entities that, within their “usual course of business,” obtain work from a labor contractor. Lab. Code § 2810.3(a)(1)(A). The term “labor contractor” is defined to include an individual or entity that supplies a client employer with workers to perform labor within the client employer’s day-to-day business operations. Lab. Code § 2810.3(a)(3).

We expect to see disputes and litigation concerning whether the work performed by contractor or staffing company employees is within the “client employer’s” “usual course of business.” The statute defines “usual course of business” as “the regular and customary work of a business, performed within or upon the premises or work site of the client employer.” Lab. Code § 2810.3(a)(6).

The new employer liability rules do not apply to workers provided by non-profit community-based organizations, apprenticeship programs, motion picture payroll services companies or third parties in certain employee leasing agreements that contractually obligates the employer to assume all of the civil legal responsibility and liability that exists under the new law.

Section 2810.3 also exempts from coverage: (1) employers with a workforce of less than 25 workers, (2) a business entity with five or fewer workers provide by labor contractors at any given time, (3) the state or any political subdivision of the state, (4) employers that are no motor carriers of property based solely on the employers’ use of a third party motor carrier of property with interstate or intrastate operating authority to ship or receive freight, (5) motor carriers of property, (6) cable providers, (7) motor club services, (8) non-profit community organizations, (9) labor organization, apprenticeship program or hiring hall operated pursuant a collective bargaining agreement, (10) motion picture payroll services, and (11) third parties engaged in an employee leasing arrangements under the California Workers’ Compensation Experience Rating...
Plan, if the employee leasing arrangement contractually obligates the client employer to assume all civil legal responsibility and civil liability.

Section 2810.3 also expressly permits indemnification provisions in agreements between client employers and labor contractors. Specifically, the statute does not prohibit employers from agreeing to any otherwise lawful remedies against labor contractors for indemnification from liability created by acts of the labor contractor. Lab. Code § 2810.3(g). Similarly, labor contractors will have the same opportunity to contract with employers for indemnification. Lab. Code § 2810.3(h).

Prior to implementation of this statute, employers typically could only be held liable for employment law violations committed by third party staffing agencies if aggrieved employees could establish the existence of a joint employment relationship between the employer and the agency (these situations will be discussed below). For liabilities created by Section 2810.3, this is no longer the case. Now, aggrieved employees can directly sue “client employers” so long as they provide notice of the alleged violations 30 days prior to filing suit. Before filing a civil action against the labor contractor’s customer, a worker (or a representative on behalf of the worker) must provide 30 days’ notice to the customer of the alleged violations. Lab. Code § 2810.3(d).

The statute requires that the “client employer” share liability for “the payment of wages.” However, many potential Labor Code violations by a “labor contractor” might not actually be violations for “the payment of wages.” For example, if a labor contractor issues improper wage statements (“paystubs”) to its employees, is that violation (Labor Code § 226(a)), a violation for “the payment of wages?” Similarly, would the “client employer” be liable for “waiting time penalties” if the labor contractor failed to pay terminating or quitting employees within the time required by California law? If the wages were paid in the correct amount, but merely paid late, would the “client employer” be liable for Labor Code § 203 “waiting time” penalties due to the labor contractor’s late payments? Since the statute only requires liability for “the payment of wages,” can a “client employer” be jointly liable for penalties (including penalties under the Labor Code Private Attorneys General Act (“PAGA”)) based on the labor contractor’s wage violations? Or is the joint liability limited only to the actual unpaid wages?

Additional regulations may follow. The new statute authorizes the Labor Commissioner, the Division of Occupational Safety and Health and the Employment Development Department to adopt necessary regulations and rules to administer and enforce the statute’s provisions.

B. The Risk of “Permatemps”: Vizcaino v. Microsoft

An important consideration for employers using contingent workers is how long they use those workers. A long assignment for a “temporary” worker increases the likelihood that that worker may actually be an employee of the “client employer.” While courts use various tests to determine the existence of an employment relationship, depending upon the particular situation (as discussed in more detail below), a common factor is the length of the relationship. This risk is most prevalent in the use of “permatemps,” which are broadly defined as long-term temporary workers who work side by side with regular employees.
An example of the potential liability from misclassifying workers is the series of class action lawsuits brought by independent contractors and “permatemps” against Microsoft in the 1990’s, relating to Microsoft’s failure to enroll these workers in employee benefits plans. These workers performed services over a continuous period, often exceeding two years. They were hired to work on specific projects and performed a number of different functions, such as production editing, proofreading, formatting, indexing, and testing. Microsoft fully integrated the workers into its workforce: they often worked on teams along with regular employees, sharing the same supervisors, performing identical functions, and working the same core hours. Because Microsoft required them to work on site, they received admittance card keys, office equipment and supplies from Microsoft. However, they were not paid for their services through Microsoft’s payroll department, but rather submitted invoices to and were paid through the accounts payable department. Microsoft did not withhold income taxes from the workers’ wages, and did not pay the employer’s share of the taxes. Moreover, Microsoft did not allow the workers to participate in the company’s benefit plans, but the workers did not complain about these arrangements at the time.

In 1989 and 1990, the IRS examined Microsoft’s records and decided that it should have been withholding and paying payroll taxes because the workers were employees rather than independent contractors. Microsoft agreed with the IRS and made the necessary corrections for the past by issuing W-2 forms to the workers and by paying the employer’s share of taxes.

Microsoft also realized that, because the workers were employees, at least for tax purposes, it had to change its system. Those workers who remained in essentially the same relationship as before were made offers to become Microsoft employees. Others had to discontinue working for Microsoft, but were provided the opportunity to work for a temporary employment agency, which could then supply temporary workers to Microsoft on an as-needed basis. Some took advantage of that opportunity.

The workers who had been independent contractors brought a class action against Microsoft, asserting that they were employees of Microsoft prior to the IRS’s ruling and should have had the opportunity to participate in the company’s benefit plans, because those plans were available to all employees who met certain other participation qualifications. Microsoft disagreed, and the workers asked the benefit plan administrator to exercise its authority to declare that they were eligible for the benefits. A panel was convened, and it ruled that the workers were not entitled to any benefits. The administrative panel seemingly indicated this was because the workers had agreed that they were independent contractors and because they had waived the right to participate in benefit plans. In the first court decision, the Court agreed with the IRS that this class of workers had been misclassified as independent contractors while being paid by the accounts payable department and were entitled to the unpaid benefits. Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997).

In a subsequent court decision, the class had been amended to include the “permatemps” who had been outsourced to staffing agencies while continuing to work for Microsoft. While the Court noted that “the triangular relationship between worker, temporary employment agency and client is not wholly congruent with the two-party relationship involving independent contractors,” it went on to hold that Microsoft could not simply change the classification of these employees by having their checks processed through staffing agencies rather than the Microsoft
accounts payable department, while they continued to enjoy the same level of integration with the company and held the same control over these workers as before. The Court held that Microsoft could be considered a joint employer of these workers and had to provide all unpaid benefits. *Vizcaino v. U.S. Dist. Court*, 173 F.3d 713 (9th Cir. 1999). Importantly, the benefit plans at issue by their very terms, excluded short-term workers. Thus, if Microsoft did not use these workers for such a long period of time, they would not have even been eligible for the plans.

While carefully-drafted benefit plans can mitigate similar risks, the Microsoft cases reveal the risk of using “temporary” workers who in essence are no longer “temporary” and in practice simply resemble ordinary company employees.

C. **Indemnity Agreements with Staffing Agencies**

Employers can (and should) include indemnity provisions in their contracts with staffing agencies. As discussed above, Labor Code Section 2810.3 expressly permits contractual remedies against a labor contractor for civil liability created by the labor contractor’s violations of certain labor laws. Lab. Code § 2810.3(g) (“This section does not prohibit a client employer from establishing, exercising, or enforcing by contract any otherwise lawful remedies against a labor contractor for liability created by acts of a labor contractor.”). Accordingly, companies that use staffing agencies should include indemnity provisions in their contracts with those agencies. Many large staffing agencies have “standard” or form agreements with their clients. An employer engaging one of the large, national staffing agencies should carefully review the indemnity language in the agency’s contract. Conversely, staffing agencies who do not have substantial market power should negotiate to limit their liability only for any possible violations committed by their supervisors or managers (e.g., the staffing agency should avoid indemnifying the “client employer” if the wrongdoing is actually the conduct of a client employer’s supervisor or employee).

Express contractual indemnity generally is enforced in accordance with the terms of the parties’ agreement. As stated in *Prince v. Pacific Gas & Electric Co.*, 45 Cal. 4th 1151 (2009), this allows contracting parties “great freedom to allocate indemnification responsibilities as they see fit,” and to agree to “protections beyond those afforded by the doctrines of implied or equitable indemnity.” However, the contractual language “must be particularly clear and explicit, and will be construed strictly against the indemnitee.” For this reason, employers should be careful to specify the occurrences or acts that for which the employer wishes to be indemnified.

In the absence of an express contract providing indemnity, California recognizes a right of equitable indemnification and employers may be able to obtain equitable indemnity from staffing agencies. Since *American Motorcycle Assn. v. Superior Court*, 20 Cal. 3d 578 (1978), California courts have recognized the equitable indemnity doctrine to permit a right of indemnity, under which liability among multiple negligent parties would be apportioned based on their fault. In *American Motorcycle Assn.*, for example, the court allowed the defendant motorcycle race sponsor to seek indemnification from the negligent parents of the race participant who caused the injuries.
Employers should also be aware of how an express indemnity agreement may potentially impact their right to equitable indemnity. The mere existence of an express indemnity agreement does not preclude equitable indemnity. According to the California Supreme Court, “[w]hen . . . the duty established by contract is by the terms and conditions of its creation inapplicable to the particular factual setting before the court, the equitable principles of implied indemnity may indeed come into play.” *E. L. White, Inc. v. City of Huntington Beach*, 21 Cal. 3d 497, 508 (1978). In *E.L. White*, the Court concluded that a general contractor could seek equitable indemnity against the City, notwithstanding the parties’ express indemnity agreement, because the scope of the agreement did not cover the City’s active negligence. However, depending on the language of an express indemnity agreement, it may preclude equitable indemnity. For example, a general contractor was not entitled to seek equitable indemnity from a subcontractor for its part in a worker’s injury, because the indemnity provision expressly applied only to damage “caused in whole” by the subcontractor, which precluded joint liability. *Regional Steel Corp. v. Superior Court*, 25 Cal. App. 4th 525, 529 (1994).

While there have not yet been any published appellate court decisions involving staffing agencies and equitable indemnity, the principle may apply in cases where fault can be apportioned between the staffing agency and the client employer. *County of San Mateo v. Berney*, 199 Cal. App. 3d 1489, 1494 (1988) (holding that equitable indemnity is not limited to actions based in tort). However, this is not a certainty, and the better course of action is to ensure that contracts with staffing agencies include express indemnity provisions. Such provisions must be carefully drafted to avoid inadvertent preclusion of the right to equitable indemnity.

**D. Payroll Services Are Not an “Employer” Under California Law**

Many employers retain the services of a payroll service to process and handle the payroll for their employees. Under California law, these payroll services are not considered an “employer” of the company’s employees, because a payroll company exercises no control over the company’s employees. *Futrell v. Payday California, Inc.*, 190 Cal. App. 4th 1419 (2010). In the *Futrell* case, the employees of a television commercial production company sued the company and its payroll service for unpaid overtime and other labor code violations. The question facing the Court of Appeal was whether the payroll service was a joint employer of the production company’s employees. The Court concluded that the payroll service was not the employer because it did not exercise control over the employees’ wages, hours or working conditions, which was controlled exclusively by the production company. Also, the payroll service did not have control over the employees’ wages because it did not have the power to negotiate or set their rate of pay. According to the Court, the task of preparing payroll does not make a payroll company an employer because the “preparation of payroll is largely a ministerial task.” Last, the payroll service did not have the power to cause the employees to work or prevent them from working, and did not control any of the details of the employees’ work.

**III. LEGAL REQUIREMENTS/ISSUES IN PARTICULAR SITUATIONS**

**A. Discrimination and Harassment Under California’s Fair Employment and Housing Act (the “FEHA”)**

1. How is an “employer” defined for FEHA purposes?
California’s prohibition against unlawful discrimination and harassment in the employment context is embodied in the Fair Employment and Housing Act (the “FEHA”). Under the FEHA, it is unlawful only for “an employer” to engage in improper discrimination or harassment. Gov’t Code § 12940(a). Accordingly, a company will be liable for discrimination or harassment suffered by its contingent workforce, only if it is found to be an employer of those workers.

The FEHA defines “employer” as “any person regularly employing five or more persons, or any person acting as an agent of an employer, directly or indirectly, the state or any political or civil subdivision of the state, and cities . . . .” Gov’t Code § 12926(d). Given this rather limited definition of the term “employer,” California courts have identified several factors that they consider to determine the existence of an employer-employee relationship for purposes of a purported employer’s liability under FEHA.

The most important factor is “the defendant’s right to control the means and manner of the workers’ performance.” Vernon v. State, 116 Cal. App. 4th 114, 126 (2004); see also McCoy v. Pacific Maritime Ass’n, 216 Cal. App. 4th 283, 302 (2013). Under this factor, the focus is not only upon the result of the work, but also the means by which the result was accomplished, and the control must be significant.

Other factors that courts consider include (1) payment of salary or other employment benefits and Social Security taxes, (2) ownership of the equipment necessary to performance of the job, (3) location where the work is performed, (4) obligation of the defendant to train the employee, (5) authority of the defendant to hire, transfer, promote, discipline or discharge the employee, (6) authority to establish work schedules and assignments, (7) defendant’s discretion to determine the amount of compensation earned by the employee, (8) skill required of the work performed and the extent to which it is done under the direction of a supervisor, (9) whether the work is part of the defendant’s regular business operations, (10) skill required in the particular occupation, (11) duration of the relationship of the parties, and (12) duration of the plaintiff’s employment.

In the Vernon case, the Court of Appeal applied these factors in a race discrimination action against the State of California, after the State enacted a safety regulation that prohibited the use of respirators by firefighter’s with facial hair. The claim was brought by a city firefighter who wore a short beard under doctor’s orders because of a skin disorder that occurs exclusively in African-Americans. The plaintiff was not a State employee but an employee of the city. The Court first explained that “[t]he fundamental foundation for liability is the existence of an employment relationship between the one who discriminates against another and that other who finds himself the victim of that discrimination.” Applying the factors discussed above, the Court concluded that the State was not liable for discrimination under the FEHA because it was not the firefighter’s employer. Specifically, the Court found that the State did not engage in the firefighter’s employment in any way; rather, he was directly employed solely by the city with no direct interference or participation by the State in the employment relationship. Further, the State did not compensate him, did not train him, did not have any authority to discipline, promote, transfer or terminate him, did not set his schedule, and did not determine or supervise his daily work. Under these circumstances, the Court concluded that the ultimate control over the means and manner of the firefighter’s employment was exercised exclusively by the city, not
2. Joint Employment: contingent workers may have more than one employer for FEHA purposes

The FEHA recognizes the possibility that an employee may have more than one employer that can be liable for violating its provisions. In such a case, the employee may look to either or both of the joint employers for enforcement of their rights under the FEHA.

In order for a company to be found liable as a joint employer for purposes of the FEHA, it must “have the right to exercise certain powers of control over the employee.” Mathieu v. Norrell Corp., 115 Cal. App. 4th 1174, 1183 (2004). In Mathieu, a woman employed by a temporary employment agency was assigned to work at the agency’s client’s location, where the woman was sexually harassed by the client’s employee. The woman sued both the temporary agency and its client with which she was placed for sexual harassment and discrimination under the FEHA. The Court concluded that both the temp agency and its client could be considered her “employer” for purposes of the FEHA, explaining that “[w]here an employer sends an employee to do work for another person, and both have the right to exercise certain powers of control over the employee, that employee may be held to have two employers—his original or ‘general’ employer and a second, the ‘special’ employer.” The Court further explained that “the purposes of FEHA are promoted if both the staffing agency and its client are treated as the employer, and employees of the client entity are treated as coworkers of employees of the staffing agency, within the meaning of FEHA.”

3. FEHA’s protection against harassment is more expansive than its protection against discrimination

While the existence of an employment relationship is the foundation for liability for discrimination, FEHA’s ban on harassment is more expansive, expressly applying to “an employee, an applicant, an unpaid intern or volunteer, or a person providing services pursuant to a contract . . . .” Gov’t Code § 12940(j)(1) (emphasis added). This protects not only independent contractors, but also their employees.

Under FEHA, a “person providing services pursuant to a contract” is defined as a person who meets all of the following criteria: (A) has the right to control the performance of the contract for services and discretion as to the manner of performance; (B) is customarily engaged in an independently established business; and (C) has control over the time and place the work is performed, supplies the tools and instruments used in the work, and performs work that requires a particular skill not ordinarily used in the course of the employer’s work. Gov’t Code § 12940(j)(5). In other words, FEHA protects independent contractors against harassment.

According to a recent decision, FEHA protects independent contractors against harassment, and also protects the employees of an independent contractor. Hirst v. City of Oceanside, 236 Cal. App. 4th 774 (2015). The Court found that the City was liable for a police officer’s sexual harassment of a phlebotomist providing services to the police department pursuant to a contract with the phlebotomist’s employer, a temporary nurse services provider. The City argued that it should not be liable because the phlebotomist was not a City employee or
a person providing services pursuant to a contract within the meaning of FEHA. Specifically, the City argued that the phlebotomist was not the person who contracted for the work but merely the employee of the independent contractor. The Court concluded that FEHA does not require the protected person to be the contracting party, explaining that a business entity can only provide services through the individuals acting on its behalf. Accordingly, the phlebotomist was covered by the FEHA and the City was liable for the officer’s harassment.

4. FEHA recognizes “aiding and abetting” liability

Even if a company is not found to be an “employer” of its contingent workers, it can be liable for aiding and abetting the actual employer’s FEHA violations. The FEHA expressly provides that it is unlawful for “any person to aid, abet, incite, compel, or coerce the doing of any of the acts forbidden under” the FEHA. Gov’t Code § 12940(i). This provision is intended to reach third party persons outside of the employer, not the employer’s employees, because a company can act only through its employees, so they are not “aiding or abetting” when acting on behalf of their employer. Reno v. Baird, 18 Cal. 4th 640, 655-56 (1998).

To be liable as an aider and abettor, a company must give substantial assistance or encouragement to the employer to commit a FEHA violation. Vernon v. State of California, 116 Cal. App. 4th 114, 135 (2004). In the Vernon case, discussed above, the court concluded that the State was not liable for aiding and abetting the alleged discrimination because the firefighter did not show that the State acted jointly with the firefighter’s employer, the City. Similarly, in a recent case, a Filipino man that was terminated by his employer, sued his union for aiding and abetting his employer’s FEHA violations after he was replaced by a younger person and two younger, non-Filipino persons were reinstated, even though they had committed the same violations for which the plaintiff was terminated. The court dismissed the claim against the Union for aiding and abetting because the plaintiff failed to show that the Union gave substantial assistance or encouragement to the employer to commit prohibited discrimination. Canedo v. Avis Budget Group, Inc., 2014 U.S. Dist. LEXIS 165856 (N.D. Cal. Nov. 26, 2014).

Aiding and abetting liability requires more than a knowing failure to prevent the harm. Fiol v. Doellstedt, 50 Cal. App. 4th 1318, 1326 (1996). An employee sued both his direct supervisor and his second-tier supervisor for sexual harassment. The employee claimed that the second-tier supervisor was liable for aiding and abetting the harassment because he knew about the harassment but did nothing to prevent it. The court concluded that the employee’s second-tier supervisor was not liable for aiding and abetting the harassment. The court explained that “[m]ere knowledge that a tort is being committed and the failure to prevent it does not constitute aiding and abetting” because the “mere failure to act does not constitute the giving of ‘substantial assistance or encouragement.’”

B. Does California Civil Code Section 51.9 Apply to Staffing Agency/Client Relationships?

California Civil Code Section 51.9 protects persons from sexual harassment committed by someone with whom they have a “business, service or professional relationship,” such as doctors, attorneys, landlords or teachers. It does not appear that any California courts have yet examined whether this statute applies to a company’s relationship with a staffing agency that
provides the company with workers.

C. Independent Contractor or Employee?

1. California’s common law test focuses on an employer’s right to control the worker’s work

California courts have long used a common law test to determine whether a worker is an independent contractor or an employee, focusing on the employer’s right to control the worker’s work. Specifically, under this common law test, “[t]he principal test of an employment relationship is whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired.” S.G. Borello & Sons, Inc. v. Dept. of Indus. Relations, 48 Cal. 3d 341, 350 (1989).

In addition to this principal test, courts also consider several secondary factors: “These include (a) whether the one performing services is engaged in a distinct occupation or business; (b) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; (c) the skill required in the particular occupation; (d) whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work; (e) the length of time for which the services are to be performed; (f) the method of payment, whether by the time or by the job; (g) whether or not the work is a part of the regular business of the principal; and (h) whether or not the parties believe they are creating the relationship of employer-employee.” Borello, 48 Cal. 3d at 351.

In the Borello case, the question was whether agricultural laborers engaged by growers were employees or independent contractors exempt from workers’ compensation coverage. The California Supreme Court found that the laborers were employees entitled to coverage. The growers argued that the laborers were independent contractors because they contracted with the laborers for only a specified result, but the laborers controlled their own work and applied skill and judgment. The Court rejected the growers’ argument, finding that the growers exercised “pervasive control” over the operation as a whole, because they owned and cultivated the land, decided what to grow, supplied tools necessary for harvesting, maintained documentation on the workers and handed out their checks. The Court found that other factors also established that the laborers were employees. The laborers formed a portion of the growers’ business operation; their work was “permanent” in the agricultural process, in that many of the same workers returned year after year; they were not engaged in a distinct occupation; they did not hold themselves out in business; they performed typical farm labor; and they invested nothing.

2. It does not matter how much control is exercised, but rather how much control could be exercised

The California Supreme Court most recently reaffirmed the common law test, in Ayala v. Antelope Valley Newspapers, Inc., 59 Cal. 4th 522 (2014). That case involved whether newspaper delivery carriers were employees or independent contractors for purposes of various wage and hour violations under the California Labor Code. While reaffirming the common law test, the Court also clarified that “what matters…is not how much control a hirer exercises, but
how much control the hirer retains the right to exercise.” According to the Court, the newspaper delivery carriers could be employees, not independent contractors, merely because the newspaper company had the ability to control their activities, whether or not it exercised that control. The Court also noted that “[p]erhaps the strongest evidence of the right to control is whether the hirer can discharge the worker without cause.” The Court’s language in Ayala is somewhat troubling: even in a clearly bona fide independent contractor relationship, the “hirer” has the right to terminate the agreement in most situations. For example, a client can almost always terminate its law firm “without cause.” That would hardly make the law firm or the law firm employees also employees of the client.

3. The IRS’s 20-Factor Test

As discussed above, many of the disputes in the Vizcaino cases arose because the IRS determined that the independent contractors and “permatemps” that performed work for Microsoft were actually employees. Currently, the IRS employs a 20-factor test to determine if a worker qualifies as an employee for federal income tax purposes. The 20 factors and a description of each follow below:

1. **Instructions:** If the person for whom the services are performed has the right to require compliance with instructions, this indicates employee status.

2. **Training:** Worker training (e.g., by requiring attendance at training sessions) indicates that the person for whom services are performed wants the services performed in a particular manner (which indicates employee status).

3. **Integration:** Integration of the worker’s services into the business operations of the person for whom services are performed is an indication of employee status.

4. **Services rendered personally:** If the services are required to be performed personally, this is an indication that the person for whom services are performed is interested in the methods used to accomplish the work (which indicates employee status).

5. **Hiring, supervision, and paying assistants:** If the person for whom services are performed hires, supervises or pays assistants, this generally indicates employee status. However, if the worker hires and supervises others under a contract pursuant to which the worker agrees to provide material and labor and is only responsible for the result, this indicates independent contractor status.

6. **Continuing relationship:** A continuing relationship between the worker and the person for whom the services are performed indicates employee status.

7. **Set hours of work:** The establishment of set hours for the worker indicates employee status.

8. **Full time required:** If the worker must devote substantially full time to the business of the person for whom services are performed, this indicates employee status. An independent contractor is free to work when and for whom he or she chooses.
9. **Doing work on employer’s premises:** If the work is performed on the premises of the person for whom the services are performed, this indicates employee status, especially if the work could be done elsewhere.

10. **Order or sequence test:** If a worker must perform services in the order or sequence set by the person for whom services are performed, that shows the worker is not free to follow his or her own pattern of work, and indicates employee status.

11. **Oral or written reports:** A requirement that the worker submit regular reports indicates employee status.

12. **Payment by the hour, week, or month:** Payment by the hour, week, or month generally points to employment status; payment by the job or a commission indicates independent contractor status.

13. **Payment of business and/or traveling expenses:** If the person for whom the services are performed pays expenses, this indicates employee status. An employer, to control expenses, generally retains the right to direct the worker.

14. **Furnishing tools and materials:** The provision of significant tools and materials to the worker indicates employee status.

15. **Significant investment:** Investment in facilities used by the worker indicates independent contractor status.

16. **Realization of profit or loss:** A worker who can realize a profit or suffer a loss as a result of the services (in addition to profit or loss ordinarily realized by employees) is generally an independent contractor.

17. **Working for more than one firm at a time:** If a worker performs more than de minimis services for multiple firms at the same time, that generally indicates independent contractor status.

18. **Making service available to the general public:** If a worker makes his or her services available to the public on a regular and consistent basis, that indicates independent contractor status.

19. **Right to discharge:** The right to discharge a worker is a factor indicating that the worker is an employee.

20. **Right to terminate:** If a worker has the right to terminate the relationship with the person for whom services are performed at any time he or she wishes without incurring liability, that indicates employee status.


4. Guidance from the Department of Labor
In July 2015, the Department of Labor issued an Administrator’s Interpretation which provided clarity on the determination of whether a worker is an employee under the Fair Labor Standards Act. See Administrator’s Interpretation No. 2015-1, The Application of the Fair Labor Standards Act’s “Suffer or Permit” Standard in the Identification of Employees Who Are Misclassified as Independent Contractors (July 15, 2015). The DOL issues Administrator’s Interpretations when “clarity regarding the proper interpretation of a statutory or regulatory issue is appropriate.” These Interpretations aim to “set forth a general interpretation of the law and regulations, applicable across the board to all those affected.” Such Interpretations are not issued in compliance with the Administrative Procedure Act, which requires formal notice of rule making and a period for public comment. Therefore, the Interpretations are not binding on a court, although courts frequently give the Interpretation some measure of deference.

The DOL’s definition of “employ” is broad and renders most workers “employees” under the FLSA. The test employed by the DOL is whether the worker is economically dependent on the employer, and thus an employee, or if the worker is truly in business for himself and economically independent from the employer, and thus an independent contractor. In doing so, the DOL applies the Supreme Court’s “economic realities” test, in Tony & Susan Alamo Found. v. Sec’y of Labor, 471 U.S. 290, 296 (1985), which “is guided by the overarching principle that the FLSA should be liberally construed to provide broad coverage for workers.” The six factors enumerated by the Supreme Court, and discussed by the DOL, are: (1) whether the work is an integral part of the employer’s business; (2) whether the worker’s managerial skill affects his or her opportunity for profit or loss; (3) how the worker’s relative investment compares to the employer’s investment; (4) whether the work performed required special skill and initiative; (5) whether the relationships between the worker and the employer is indefinite; and (6) the nature and degree of the employer’s control over the worker. In doing so, the DOL reminds employers that each factor must be examined, and no factor is determinative.

The Administrator’s Interpretation on this topic suggests that companies can expect heightened scrutiny and litigation as a result. The litigation would likely be focused on the individual engagement of independent contractors by companies, particularly companies that engage workers who perform duties similar to company’s employees on a long-term basis.

It remains to be seen whether the change in the Presidential administration will affect the DOL’s approach to this issue.

D. Wage and Hour Violations Under the California Labor Code and the Fair Labor Standards Act (the “FLSA”)

1. California uses an expanded definition of “employer” in actions for violations of the Industrial Welfare Commission’s (“IWC”) Wage Orders

California’s wage and hour laws are governed by the California Labor Code and the Industrial Welfare Commission’s (“IWC”) Wage Orders. California Labor Code Section 1194 expressly permits employees to sue for unpaid wages or overtime, but it does not define “employer.” However, the Wage Orders define “employer” broadly to include “any person . . . who directly or indirectly, or through an agent or any other person, employs or exercises control over the wages, hours, or working conditions of any person.” 8 Cal. C. Regs § 11140(2)(G).
The Wage Orders further define “employ” as “to engage, suffer, or permit to work.” 8 Cal. C. Regs § 11140(2)(C).

In 2010, the California Supreme Court answered the question who is liable in actions under Section 1194, holding that the IWC’s Wage Orders generally define the employment relationship and who may be liable. *Martinez v. Combs*, 49 Cal. 4th 35, 52 (2010). That case involved a class action for unpaid wages under Labor Code Section 1194 brought by farm workers against both their employer and the produce merchants through which the employer sold strawberries. The Court ultimately concluded that “to employ” within the meaning of the IWC’s Wage Orders has three alternative definitions: (1) to exercise control over the wages, hours or working conditions; (2) to suffer or permit to work; or (3) to engage, thereby creating a common law relationship.

After a lengthy examination of Section 1194’s historical and statutory context, the Court concluded that the Legislature intended to defer to the IWC’s definition of the employment relationship in actions under the statute. Further, the Court explained that a worker who sues for unpaid wages under Section 1194 actually sues to enforce the applicable Wage Order, and applying only the common law definition of employment would substantially impair the IWC’s authority and the effectiveness of its Wage Orders.

This is the test that California courts currently apply to determine if a company is the employer or joint employer of its contingent workers in actions for violations of the IWC’s wage orders. A company will be liable if it meets any one of the alternative definitions.

(A) Control over wages, hours or working conditions

Control over any one of an employee’s wages, hours or working conditions is sufficient to establish an employment relationship. In *Martinez*, the Court explained that “the scope of the IWC’s delegated authority is, and has always been, over wages, hours and working conditions. For the IWC to adopt a definition of ‘employer’ that brings within its regulatory jurisdiction an entity that controls any one of these aspects of the employment relationship makes eminently good sense.” 49 Cal. 4th at 59. The Court further explained that phrased in the alternative this definition “has the obvious utility of reaching situations in which multiple entities control different aspects of the employment relationship.” Accordingly, a company will be liable as an employer if it exercises control over any one of its workers’ wages, hours or working conditions.

First, a company exercises control over wages when it has the power or authority to negotiate and set an employee’s rate of pay. *Futrell*, 190 Cal. App. 4th at 1432. In the *Futrell* case discussed above, the Court concluded that a payroll company did not exercise control over the wages of a television commercial production company’s employees, because the payroll service did not negotiate or set the employees’ rate of pay, but only handled the ministerial tasks of calculating pay, withholding taxes and issuing paychecks.

In contrast, in an action brought by field workers against its employer and the vineyard that contracted with their employer for their services, a federal district court concluded that the vineyard was a joint employer of the workers because it negotiated and set the workers’ rate of pay as part of its contract with their employer. *Arredondo v. Delano Farms Co.*, 922 F. Supp. 2d
Second, a company exercises control over hours when it has the power to set an employee’s hours, direct when and where the employee reports to work and when to take breaks, and compel the employee to work. In the *Martinez* case discussed above, the Court concluded that the produce merchants did not exercise control over the farm workers’ hours because there was no evidence that the merchants ever compelled the farmers to work, and the farmers’ employer set their hours, directed when and where to work, and directed when to take their breaks.

Third, working conditions may include aspects of the relationship such as hiring and firing, training, supervision, assigning work and providing equipment and supplies. For example, employees of a cleaning company that contracted to clean FedEx planes and other vehicles sued FedEx for various wage and hour violations. The court concluded that the employees met their burden to establish that FedEx was their joint employer for purposes of class certification, finding that FedEx controlled the employees’ working conditions by providing all of the employees’ equipment and supplies, training them how to perform their cleaning tasks, supervising their work, assigning tasks to them directly and influencing the cleaning company’s hiring and firing. *Torres v. Air to Ground Services, Inc.*, 300 F.R.D. 386 (C.D. Cal. 2014).

(B) Suffer or permit to work

A company suffers or permits employees to work when it knows the employees are being paid less than minimum wage, and the company has the power to cause the employees to work or prevent them from working. In both *Martinez* and *Futrell*, the Courts concluded that the purported joint employers did not suffer or permit the employees to work because neither had the power to prevent the employees from working; rather, the employees’ actual employers had the exclusive right to hire and fire the employees. The Court in *Martinez* explained that “the basis of liability is the defendant’s knowledge of and failure to prevent the work from occurring.” 49 Cal. 4th at 70.

In contrast, in an action brought by an in-home support services provider against a county and public authority, the Court of Appeal concluded that they were joint employers of the service provider because they could effectively terminate the provider by terminating the service recipient’s participation in the program. *Guerrero v. Superior Court*, 213 Cal. App. 4th 912 (2013).

(C) To engage, creating a common law employment relationship

The IWC’s definition of employment incorporates the common law test discussed above as one alternative. *Martinez*, 49 Cal. 4th at 64. In *Martinez*, the Court explained that “to engage,” as used in the IWC’s definition of “employ,” has no other apparent meaning than its plain, ordinary sense of creating a common law employment relationship. According to the Court, this conclusion makes sense because the IWC could not have intended to withhold protection from the regularly hired employees making up the vast majority of the workforce.
2. Corporate officers and directors generally are not individually liable

Corporate officers and directors are not normally individually liable for wage and hour violations. In Reynolds v. Bement, 36 Cal. 4th 1075 (2005), a former employee of an automobile painting business brought a claim for unpaid overtime wages against several individuals who were officers, directors, or shareholders of the corporation that owned the business, contending that they were his employers because they exercised control over his wages. The California Supreme Court concluded that the officers and directors were not individually liable to the employee. The Court cited long-settled law that “directors or officers of a corporation do not incur personal liability for torts of the corporation merely by reason of their official position.” As a result, the Court held that corporate agents acting within the scope of their agency are not personally liable for the corporate employer’s failure to pay its employees’ wages. Additionally, the Martinez decision, discussed above, affirmed that Reynolds “properly holds that the IWC’s definition of ‘employer’ does not impose liability on individual corporate agents acting within the scope of their agency.”

3. When does the common law test apply, and when does Martinez apply?

This currently remains an open question, but a case currently pending before the California Supreme Court should answer it. In a recent wage and hour class action brought by courier drivers against a courier service for misclassifying them as independent contractors, the Court of Appeal concluded that the trial court properly applied the Martinez test. Dynamex Operations, Inc. v. Superior Court, 230 Cal. App. 4th 718 (2014). The Court held that the Martinez test applies when a plaintiff’s claims fall within the scope of the IWC wage orders, and that the common law test applies when the claims fall outside the scope of the wage orders. The Court explained that the common law test was not focused on the protection of employees, but arose to meet the needs of employers and protect them against vicarious liability for their employees’ misconduct. It further explained that the employee-centric Martinez test fills the gap between the common law employer-focused approach and the need for a standard focused on the needs and protection of employees.

On November 24, 2014, the California Supreme Court accepted review of the Court of Appeal’s Dynamex decision, to determine whether the common law test or the Martinez test should apply. Briefing in Dynamex is complete but the case has not yet been set for oral argument. The decision is likely to define or focus the joint employment standard for alleged wage and hour violations under the Wage Orders.

4. Can an “upstream” employer also be liable for penalties against a staffing agency or subcontractor, under California’s Private Attorneys General Act (“PAGA”)?

Under California’s PAGA, employees may sue their employers to collect civil penalties for violations of certain Labor Code provisions. One federal judge held that an “upstream” employer may potentially be liable for PAGA penalties, in addition to the staffing agency, where the two are determined to be joint employers. For example, in Hernandez v. DMSI Staffing, LLC, 2015 U.S. Dist. LEXIS 12824 (N.D. Cal. Feb. 3, 2015), a warehouse employee hired and paid through a temporary service company (but controlled and managed by the company owning
the warehouse) alleged she was jointly employed by DMSI and Ross to work in Ross’s
warehouse as a non-exempt employee who was paid by the hour. DMSI is a temporary staffing
company that provides temporary staffing to Ross, a retail apparel store. While the case largely
centered on the question of the enforcement of the arbitration clause for the PAGA claims, the
court accepted without discussion that a PAGA claim could be brought against a joint employer.

However, California Labor Code § 2699.3 requires an employee to meet specific
procedural requirements to bring a PAGA claim against any employer. These requirements
include providing the employer with notice of the claim and the opportunity to cure prior to
filing a civil action. Failure to meet these requirements may act as a procedural bar to the
employee’s claim. Thus, an employee supplied by a staffing agency likely will not be able to
maintain a claim for PAGA penalties against an “upstream” employer, if the employee only
provided notice to the staffing agency.

5. Special rules for California garment manufacturers

To ensure payment of wages to employees engaged in garment manufacturing, California
Labor Code Section 2673.1 expressly provides that “any person” who contracts with another to
have garments manufactured guarantees minimum wage and overtime compensation due to the
other person’s employees. Accordingly, liability for unpaid wages extends beyond garment
workers’ actual employers.

In a defamation action brought by a clothing retailer against an advocacy organization
that represented low-income immigrant workers, following a dispute regarding whether the
retailer was responsible for the workers’ unpaid wages under Labor Code Section 2673.1, the
court concluded that the retailer was liable for the wages and would be unlikely to prevail on its
defamation claim. In Fashion 21 v. Coalition for Humane Immigrant Rights of Los Angeles,
117 Cal. App. 4th 1138 (2004), the workers were part of the production and assembly lines for
garments sold at the retailer’s stores. The retailer did not own or have a financial interest in the
manufacturers that produced its garments and never directly employed the workers. In
concluding that the retailer was liable for the workers’ wages, the court adhered to the Labor
Commissioner’s interpretation of Section 2673.1, that a retail business contracting with a
manufacturer to produce a specified line of apparel has a statutory obligation to guarantee the
minimum and overtime wages the manufacturer pays its employees.

In addition, under California Labor Code Section 2677, “any person” who contracts with
an unregistered garment manufacturer is the “deemed employer” for most Labor Code violations.
Labor Code Section 2677 states that “[a]ny person engaged in the business of garment
manufacturing who contracts with any other person similarly engaged who has not registered
with the commissioner or does not have a valid bond on file with the commissioner, as required
by Section 2675, shall be deemed an employer, and shall be jointly liable with such other person
for any violation of Section 2675 and the sections enumerated in that section.”

California courts have explained that “extending liability beyond the employer is
essential to the purpose of section 2677 to end the practice in the garment industry of
manufacturers evading responsibility for certain labor violations.” In Bradstreet v. Wong,
161 Cal. App. 4th 1440 (2008), a garment manufacturing company that lost its registration
contracted with another corporation under the same ownership and management. The court concluded that the individual owners, officers and managers of the corporation were not liable under Section 2677 because they were not the contracting party, but that the corporation itself could qualify as the “deemed employer” because it was the person who contracted with the garment manufacturer. The court explained that the purpose of section 2677 is fully served by holding the contracting person liable for labor code violations committed by the unregistered manufacturer whose workers performed labor that benefited the contracting person.

6. Special rules for construction, farm labor, garment, janitorial and security guard contracts, under California Labor Code Section 2810

California Labor Code Section 2810(a) provides that “[a] person or entity shall not enter into a contract or agreement for labor or services with a construction, farm labor, garment, janitorial, security guard, or warehouse contractor, where the person or entity knows or should know that the contract or agreement does not include funds sufficient to allow the contractor to comply with all applicable local, state, and federal laws or regulations governing the labor or services to be provided.”

This has been interpreted to mean that employers that contract for services with contractors in the trades identified in Section 2810(a) may be liable for wage and hour violations if their contracts do not provide sufficient funds to cover employees’ wages. For example, in wage and hour class actions brought by subcontractors’ employees against a home builder, the court concluded that the some of the builder’s contracts with the subcontractors provided adequate funds to permit the subcontractors to pay their employees minimum wage but other contracts did not. *Castillo v. Toll Bros., Inc.*, 197 Cal. App. 4th 1172 (2011). In *Castillo*, the court explained that “[e]ven the most generously funded employer may commit labor law violations from greed, ignorance, or mismanagement, but the contracting party is not responsible for such violations so long as the contract price is sufficient.” Additionally, the court also concluded that the state minimum wage is the proper wage standard to evaluate the sufficiency of the contract pursuant to Section 2810(a). Further, the contracting party can only be liable if it knew or should have known at the time the contract was executed that it was reasonably likely to be insufficient, and the contract price actually proved insufficient.

The court in *Castillo* considered each contract separately in concluding that the builder did not know that certain contracts were insufficient because the contractor and subcontractors believed the contracts were sufficient based on years of experience in the industry about the man hours necessary to complete the work. However, the court concluded that the builder knew or should have known that other contracts were insufficient, because the funds remaining after payment of costs and overhead, using standard methods employed in the industry to prepare bids, were likely to be insufficient to pay the employees minimum wage.

7. The definition of “employer” under federal law is even broader than California’s definition in some respects

Federal wage and hour laws are governed by the Fair Labor Standards Act (the “FLSA”). Whereas officers and directors generally are not personally liable for unpaid wages under the California Labor Code, the FLSA expressly imposes liability on “any person” acting on behalf of
the employer, including its officers, directors, and employees’ supervisors. Thus, under federal law, particular individuals, including corporate officers and directors and direct managers or supervisors of contingent workers, may be personally liable for wage and hour violations.

Specifically, the FLSA defines “employer” as “any person acting directly or indirectly in the interest of an employer in relation to an employee . . . .” 29 U.S.C. § 203(d). Courts have determined that this definition is to be given an “expansive interpretation” to effectuate the FLSA’s broad remedial purposes. Boucher v. Shaw, 572 F.3d 1087, 1091 (9th Cir. 2009). For example, in the Boucher case, former employees sued their individual managers for unpaid wages under the FLSA, because their former employer filed for bankruptcy. The Ninth Circuit held that the managers were independently liable for the FLSA wage and hour violations. The Court explained that “[w]here an individual exercises ‘control over the nature and structure of the employment relationship,’ or ‘economic control’ over the relationship, that individual is an employer within the meaning of the Act, and is subject to liability.”

To determine if a person is an “employer” within the meaning of the FLSA, federal courts use an “economic reality” test to consider the totality of the circumstances of the relationship. Under this economic reality test, the Ninth Circuit, in which California is located, has long looked to four factors in particular: whether the alleged employer (1) had the power to hire and fire the employees, (2) supervised and controlled the employees’ work schedules or conditions of employment, (3) determined the employees’ rate and method of payment, and (4) maintained employment records. Bonette v. California Health and Welfare Agency, 704 F.2d 1465, 1470 (9th Cir. 1983). While these four factors provide a useful framework, they are not “etched in stone and will not be blindly applied.” In Bonette, individuals who provided in-home care to disabled public assistance recipients brought an action for unpaid wages under the FLSA against state and county agencies. The Court concluded that the state and counties were the individuals’ employers under the FLSA, because they paid the workers’ wages, controlled the rate and method of payment, maintained employment records, determine the hours worked and tasks performed, and had complete economic control over the relationship.

The following examples illustrate individuals’ liability for wage violations under the FLSA:

- A corporation’s president was personally liable for FLSA violations where he had ultimate control over day-to-day operations, and was the person in charge of setting employee wages and schedules. Chao v. Hotel Oasis, Inc., 493 F.3d 26 (1st Cir. 2007).

- A bank officer who was the employee’s immediate supervisor and who reviewed the employee’s work and made recommendations concerning salary and promotion was liable as an “employer.” Koster v. Chase Manhattan Bank, 554 F. Supp. 285 (S.D.N.Y. 1983).

8. DOL’s 2016 Administrator’s Interpretation on joint employment under the FLSA

In 2016, the Department of Labor issued an Administrator’s Interpretation which
established a new expansive standard for determining joint employment under the FLSA. See Administrator’s Interpretation No. 2016-1, Joint Employment under the Fair Labor Standards Acts and Migrant and Seasonal Agricultural Worker Protection Act (January 20, 2016). This affects wage and hour claims under the FLSA because “[w]hen two or more employers jointly employ and employee, the employee’s hours worked for all the joint employers during the workweek are aggregated and considered as one employment, including for purposes of calculating whether overtime pay is due.” Further, the new position ensures that the broadest possible number of employees are covered by the Act according to the Interpretation, the DOL “may consider joint employment to achieve statutory coverage, financial recovery, and future compliance, and to hold all responsible parties accountable for their legal obligations.”

Though not binding on courts, under the new proposed standard, the DOL applies the “economic reality” test used under the Migrant and Seasonal Agricultural Worker Protection Act to assess any possible joint employment relationship in cases under FLSA. The factors under this test are: (1) whether the purported employer directs, controls, or supervises workers; (2) whether the purported employer has the power to hire, fire, and modify the employment conditions, including rates of pay; (3) the degree of permanency and duration of the parties’ relationship; (4) the extent to which the service rendered by the workers is repetitive or rote by nature; (5) whether the work performed is integral to the overall business of the purported employer; (6) whether the work is performed on the putative employer’s premises; and (7) whether the responsibilities performed by the putative employer are those commonly performed by employers.

9. The Ostensible agency theory

In late 2015, a federal district court in the Northern District of California certified a class of more than 800 workers employed by a McDonald’s franchisee to pursue wage and overtime claims. While the court entered summary judgment in favor of McDonald’s for the claim that McDonald’s was directly liable as a joint employer with the franchisee, the court found triable issues of fact whether McDonald’s might be indirectly liable if the franchisee was the “ostensible agent” of McDonald’s. Ochoa v. McDonald's Corp., 133 F. Supp. 3d 1228, 1239 (N.D. Cal. 2015).

Under California law, ostensible agency exists where (1) the person dealing with the agent does so with reasonable belief in the agent’s authority, (2) that belief is “generated by some act or neglect of the principal sought to be charged,” and (3) the relying party is not negligent. In other words, the employee needs to have the reasonable belief that they were employed by McDonald’s. As a threshold issue, the court held that there was no bar to class certification in ostensible agency cases, despite McDonald’s claim that ostensible agency, by definition, involves individualized, personal beliefs; rather, the court must balance individual and common issues.

Ultimately, the court found that the franchisee workers had shown “substantial and largely undisputed evidence” – employees were required to wear McDonald’s uniforms, used McDonald’s packaging, and worked in an area emblazoned with the McDonald’s logo – “that the putative class was exposed to conduct in common that would make proof of ostensible agency practical and fair on a class basis.” On the other hand, the court found that McDonald’s
had submitted “no evidence at all” that class members did not believe or unreasonably believed that McDonald’s was their employer. Finally, the court held that ostensible agency could be implied from circumstances.

McDonald’s has appealed the ruling to the Ninth Circuit, relying on the argument that ostensible agency requires an inquiry into individualized mental states that are not appropriate for class certification. Further, McDonald’s argues that it did indeed provide evidence of the employees’ belief that they were employed by a franchisee, rather than McDonalds, including signed agreements explicitly stating that they were “an employee-at-will of an independently owned and operated McDonald’s franchise.”

The ostensible agency theory is novel and to our knowledge has never been the basis of a judgment upheld on appeal against a “principal” (i.e., client employer or franchisor) for California Labor Code violations of a second employer.

E. Are Franchisors Liable to Franchisees’ Employees?

Franchising is a lucrative and thriving business model for both the franchisor and franchisee. The franchisor sells the right to use its trademark and business plan, expanding its enterprise without the risk and cost of running its own stores. In turn, the franchisee profits from the expertise, goodwill and reputation of the franchisor, while independently owning and operating its own stores. Crucial to the success of this model is the implementation of comprehensive and meticulous standards for marketing the franchisor’s trademark and operating the stores in a uniform manner. However, in this way, the franchisor controls the enterprise. In the employment context, courts are faced with the question of whether a franchisor’s uniform marketing and operation plans are sufficient to establish an employment relationship between the franchisor and its franchisees’ employees.

1. California Law

Under California law, a franchisor must assume some control over the relevant day-to-day operations of the franchisee to be liable to the franchisee’s employees as a joint employer. *Patterson v. Domino’s Pizza, LLC*, 60 Cal. 4th 474, 503 (2014). *Patterson* is an important 4-3 decision, in which the California Supreme Court held that the Domino’s Pizza franchisor was not liable under the FEHA for the alleged sexual harassment committed by a Domino’s franchisee supervisor against a female subordinate. At the outset, the Court observed that “[t]he imposition and enforcement of a uniform marketing and operational plan cannot automatically saddle the franchisor with responsibility for employees of the franchisee who injure each other on the job.” The majority then relied heavily on the franchise agreement and the “uncontradicted evidence…that the franchisee imposed discipline consistent with its own personnel policies, declined to follow the ad hoc advice of the franchisor’s representative, and neither expected nor sustained any sanction for doing so.” Further, the franchisee implemented his own sexual harassment policy and training program, without any input from Domino’s. The Court found that Domino’s lacked any authority to manage the behavior of the franchisee’s employees while performing their jobs, including any acts that might involve sexual harassment. Accordingly, the Court concluded that “[a] franchisor will be liable if it has retained or assumed the right of general control over the relevant day-to-day operations at its franchised locations . . . .” This
important decision requires some direct involvement by the franchisor in the conduct of the franchisee, in order for the franchisor to be liable.

*Patterson* was a 4-3 decision and one of the Justices in the majority was now-retired Justice Marvin Baxter. The California Supreme Court has two new Justices appointed in 2014 by Governor Jerry Brown (Justice Mariano Florentino Cuellar and Justice Leondra Kruger). It is unclear how either Justice Cuellar or Justice Kruger would have viewed the *Patterson* facts.

Following the *Patterson* decision, it appears that courts will apply the same standard in wage and hour actions brought against franchisors and franchisees under the California Labor Code. In a recent decision from the Southern District of California, a massage therapist sued the franchisee that employed him and the franchisor for unpaid wages under the California Labor Code. Applying *Patterson*, the court concluded that the franchisor was not a joint employer because it did not control its franchisees’ pay policies. *Vann v. Massage Envy Franchising LLC*, 2015 U.S. Dist. LEXIS 1002 (S.D. Cal. Jan. 5, 2015). Specifically, the court found that the lack of uniformity of pay policies among franchises suggested that the franchisor left control of employee wages and hours to the franchisees, the franchise agreement indicated that a franchisee had the exclusive right to hire and fire its employees, the plaintiff testified that he never had any interaction with the franchisor, and the franchisor did not exercise control over the day-to-day operations of the franchisee. The court also concluded that the franchisor’s policies on attire, types of massages offered, types of products used during a massage and types of conversations that masseurs could have with clients were policies to assist in brand uniformity.

2. Federal Law

Under federal law, courts apply an “economic reality” test to determine if franchisors are joint employers in actions for wage and hour violations under the FLSA and discrimination under Title VII. Under this test, courts consider whether the franchisor (1) had the power to hire and fire; (2) supervised and controlled employee work schedules or conditions of employment; (3) determined the rate and method of pay; and (4) maintained employment records. *Orozco v. Plackis*, 757 F.3d 445 (5th Cir. 2014). In *Orozco*, a franchisee employee sued the franchisor for unpaid wages under the FLSA, but the court concluded that the franchisor was not liable as a joint employer. Applying the “economic reality” test, the court found that the franchisor did not have the power to hire or fire the employee, did not supervise and control the employee’s work schedule or conditions of employment and did not determine the employee’s rate of pay and method of payment.

In a sexual harassment action under Title VII, a court similarly concluded that a franchisor was not liable as a joint employer under the economic reality test. *Courtland v. GCEP-Surprise*, LLC, 2013 WL 3894981 (D. Az. July 29, 2013). In that case, a former bartender and server at a franchised Buffalo Wild Wings restaurant sued the franchisor for sexual harassment and discrimination committed by the restaurant manager and assistant manager. The court found that the franchisor was not a joint employer, because it did not have the right to hire, fire or supervise franchisee employees, it did not compensate the employees and was not responsible for payroll or recordkeeping, it did not train non-managerial staff, it did not provide any HR support, and it did not influence the conduct of daily operations or share in the franchisee’s profits.
While the economic reality test requires federal courts to consider the totality of the circumstances, the common hallmarks of a franchise (namely, requirements that “protect the brand”) are not considered in the employment relationship analysis. *Juarez v. Jani-King of California, Inc.*, 273 F.R.D. 571 (N.D. Cal. 2011). For example, in *Juarez*, the plaintiffs sued a franchisor for various wage and hour violations, claiming that the franchisor’s policies and practices so tightly controlled the franchisees’ actions that it created an employment relationship between the franchisor and the franchisee’s employees. The plaintiffs presented franchise manuals and other documents to show that the franchisor directed franchisees’ method of cleaning, their cleaning schedule, their contact with customers and manner of dress; that franchisees were required to notify the franchisor before going on vacation; that franchisees were required to notify the franchisor of customer complaints and follow specific procedures; and that franchisees must get franchisor approval before establishing an office location, using a trade or business name and creating a vehicle display. The court concluded that a franchisee must show that the franchisor exercised “control beyond that necessary to protect and maintain its interest in its trademark, trade name and goodwill” to establish an employment relationship. Thus, the court excluded facts showing the common hallmarks of a franchise from the employer-employee analysis and found there was very little common evidence to prove an employer-employee relationship between the franchisor and franchisee’s employees.

Similarly, in a FLSA action brought by employees against their former employer and 7-Eleven franchisor, the court found that 7-Eleven was not the plaintiffs’ employer. *Singh v. 7-Eleven, Inc.*, 2007 WL 715488 (N.D. Cal. Mar. 8, 2007). The court held that “simply setting the standards without actual control of day-to-day operations is not sufficient to establish an employer-employee relationship between 7-Eleven and plaintiffs.” The court explained that “such policies are merely reflective of inherent interrelation of operations between the two entities and 7-Eleven’s goal of attaining conformity to certain operational standards and details.”

By contrast, the NLRB’s General Counsel has argued to the contrary in the massive unfair labor practice proceeding now in trial in New York (discussed below): the General Counsel claims that restrictions or measures taken to “protect the brand” can be considered in determining whether a franchisor, under the NLRB, is a joint employer with a franchisee.

In August 2016, the DOL announced an alliance with Subway restaurants organization in an attempt to improve franchisee compliance with wage and hour laws. Under the new agreement, the DOL and Subway will share data to determine compliance with labor laws, and work together to develop training materials for franchisees, including the possibility of payroll and scheduling software to ensure compliance. Some, including the International Franchise Association, have warned that these new initiatives could be used as evidence of a joint employer relationship in private party or agency litigation and by the NLRB. In fact, the NLRB has previously asserted scheduling and point-of-sale software as evidence of a joint employer relationship between McDonalds USA and its franchisees. This development is especially pertinent in light of the *Browning-Ferris* decision, which has loosened the NLRB’s definition of a joint employer.

F. National Labor Relations Act

The Board has jurisdiction over essentially two types of cases: “representation” cases,
where a union seeks, usually through an election petition, to represent employees of an employer, and “unfair labor practice” cases, where an employer, a union or an individual employee files a charge alleging that someone else has committed an unfair labor practice. Unfair labor practice cases are in some way similar to civil litigation. But the joint employer issue can arise in both types of cases. For example, the union may seek to represent a “unit” of workers at a facility which includes both direct employees of the employer and agency employees working side by side with the employer’s personnel. Historically, the Board in 2004 held that such “mixed” units could not be the subject of an election unless the agency consented to have its employees vote along with the employer’s own employees.

However, on July 11, 2016, a divided NLRB overturned the 2004 decision, holding that, in representation proceedings, an election in a “mixed” bargaining unit (i.e., a unit including both direct and agency employees) could occur even over the objections of one of the two employers. Miller & Anderson, Inc., 364 NLRB No. 39 (2016).

1. NLRB proceedings against McDonald’s

The Board has authorized a series of unfair labor practice complaints against McDonald’s USA, LLC and numerous McDonald’s independent franchisees. The Board’s General Counsel asserts that McDonald’s USA, LLC is a “joint employer” with all of its franchisees nationwide. These cases have been consolidated in a single case focused in New York City, although there will eventually be trials in Chicago and Los Angeles as well. Trial in the New York case began in March 2016, and through early November 2016 had involved at least 65 days of hearings, all of it involving the joint employer issue. Trial in the New York proceeding is expected to continue well into 2017.

2. Former NLRB joint employer standard

From 1984 until August 2015, the NLRB test for joint-employer status considered whether two entities “share or codetermine those matters governing the essential terms and conditions of employment.” The NLRB under this standard required proof of a significant or substantial degree of “direct or immediate” control, not merely potential control, by an employer over hiring, firing, discipline, supervision, and direction of the other employer’s employees. For example, in Flagstaff Medical Center, Inc., 357 NLRB No. 65 (2011), an action involving unfair labor practices, the NLRB applied this standard in finding that a hospital and the company it contracted with to provide managers to oversee the hospital’s housekeeping staff were not joint employers. The Board concluded that the company that provided the managers was not a joint employer with the hospital because it played no role in formulating policy relating to hiring, terms and conditions of employment, rates of pay, performance review, discipline and termination. Rather, those matters were dictated by the hospital.

3. The Browning-Ferris case and its effects

In 2015, the NLRB reversed more than 30 years of established precedent, expanding the joint employer standard, lowering the evidential threshold necessary to establish a joint employer relationship under the Act. In Browning-Ferris Indus. of Cal., Inc., 362 NLRB, No. 186 (2015), the Board eliminated the requirement that the employers exercise “direct and immediate” control
over the employees. Instead, the Board may now find that two or more statutory employers are joint employers of the same statutory employees if they “share or codetermine those matters governing the essential terms and conditions of employment.” In determining this, the Board and courts will “consider the various ways in which joint employers may ‘share’ control over terms and conditions of employment or ‘codetermine’ them, as the Board and courts have done in the past.” The Board “will evaluate the evidence to determine whether a user employer affects the means or manner of employees’ work and terms of employment, either directly or through an intermediary.”

The *Browning-Ferris* case is currently on appeal in the D.C. Circuit. The Equal Employment Opportunity Commission has filed an amicus brief in support of the NLRB’s new joint employer standard. The EEOC amicus brief argues that the new test is neither vague nor unworkable; in fact, EEOC asserts it has used essentially the same test to determine joint employment status in the employment discrimination context. Though the EEOC concedes that the new “flexible” test may cause more uncertainties than the former standard, “uncertainty . . . is no basis for rejection a rule that is consistent with statutory language, common law and legislative purpose.”

Since *Browning-Ferris*, the Board has applied the new test, showing the expansive effect the decision will have on future joint employer cases. In *Miller & Anderson, Inc.*, 364 NLRB, No. 39 (2016), the union had petitioned for a bargaining unit of all sheetmetal workers at various job sites, some of whom were directly employed by the sheetmetal company and others who were supplied by a temp agency. Applying “traditional community of interest standards,” the Board held 3-1 that employees who are solely employed by an employer may be combined for a representation election with individuals jointly employed by another company without either employer’s consent. In *Retro Environmental, Inc./Green Jobworks, LLC*, 364 NLRB, No. 70 (2016), the Board held that Retro Environment, a construction company, and Green Jobworks, a staffing agency, were joint employers of a group of full and part-time workers that a union was seeking to represent. The Board found that the construction company had control of who the staffing agency hired, and the employers had failed to prove that the cessation of their joint operations was imminent and definite. One Member of the Board dissented on the grounds that the majority was ruling on speculation regarding the employer’s future relationship.

As previously mentioned, the NLRB currently has two vacancies. Additionally, over time, given the results of the 2016 election, the NLRB will have a 3-2 majority of Republican appointees, at least for the duration of the Trump Administration. Whether the “Trump NLRB” will retain the *Browning-Ferris* holding is open to question.

G. **Parent/Subsidiary Relationships**

A parent corporation’s ownership and limited involvement in its subsidiary’s operations may render the parent the “employer” of its subsidiary’s employees. *Castaneda v. Ensign Group*, 229 Cal. App. 4th 1015, 1017-18 (2014). In *Castaneda*, a class of certified nursing assistants sued the parent company of their employer for unpaid wages under the California Labor Code. The Court of Appeal concluded that “if the [parent] corporation with no employees exercises some control over the [subsidiary] corporation with employees, [the parent] also may be the employer of the [subsidiary] corporation it owns.” In addition to owning the subsidiary
directly, the parent entity provided training videos to the subsidiary’s employees, instituted specific software systems for use in the subsidiary’s business, provided or helped administer the subsidiary’s employee benefit plans, and used a parent-provided complaint form for resolution of employee disputes. Despite these facts, there was no evidence that the parent company actually was involved in the employment practices at issue (alleged overtime and minimum wage violations). Nevertheless, the Court found that there was a triable issue whether the parent was the employer of the subsidiary’s employees.

Courts have also recognized that a parent may be liable for its subsidiary’s employment discrimination under a four-part “integrated enterprise” test. *Kang v. U. Lim America, Inc.*, 296 F.3d 810 (9th Cir. 2002). The four factors are (1) interrelation of operations; (2) common management; (3) centralized control of labor relations; and (4) common ownership or financial control. In *Kang*, the court concluded that the parent and its subsidiary were an integrated enterprise, so that the parent could be liable for discrimination under Title VII. The parent and subsidiary (1) shared a facility, where all employees worked, and the parent kept the subsidiary’s accounts, issued its paychecks and paid its bills; (2) the subsidiary’s president was also the vice president of the parent, and the subsidiary’s supervisors reported directly to the parent’s managers; (3) the parent had the authority to hire and fire subsidiary employees; and (4) both companies were owned and controlled by the same person. California courts have also used the integrated enterprise test with regard to parent/subsidiary relationships. *Laird v. Capital Cities/ABC, Inc.*, 68 Cal. App. 4th 727 (1998).

**H. Contingent Workers and the Employer Penalty Under the Affordable Care Act (“ACA”): What Employers Should Know**

The Affordable Care Act creates a new employer “play or pay” tax penalty, also known as the “Employer Mandate.” Employers who hire workers as contractors through staffing firms, leasing arrangements, or directly will want to consider how these contingent workers fit with the employer’s approach to the Employer Mandate.

1. **Background on the Employer Play or Pay Penalty**

To “play” under the Employer Mandate, a large employer (generally an employer with 50 or more full-time and full-time equivalent employees) must offer health coverage that is “minimum essential coverage,” is “affordable,” and satisfies a “minimum value” requirement to its full-time employees and their children. “Minimum essential coverage” includes fully-insured and self-insured major medical coverage offered under an employer-sponsored group health plan or through a multiemployer plan, MEWA, or staffing organization (provided certain requirements are satisfied). Coverage is “affordable” if an employee’s required contribution for the lowest-cost self-only coverage option offered by the employer does not exceed 9.5 percent of the employee’s household income. Coverage provides “minimum value” if the plan’s share of

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the actuarially projected cost of covered benefits is at least 60 percent.

If a large employer does not “play” for some or all of its full-time employees, the employer will have to pay a penalty in two scenarios. The first scenario occurs when an employer does not offer health coverage that is “minimum essential coverage” to “substantially all” of its full-time employees and any one of its full-time employees both enrolls in health coverage offered through a state insurance exchange, which is also called a marketplace (an “Exchange”), and receives a premium tax credit or a cost-sharing reduction (an “Exchange subsidy”). In this scenario, the employer will owe a “no coverage penalty.” The no coverage penalty is $2,000 per year (adjusted for inflation after 2014) for each of the employer’s full-time employees (excluding the first 80 for the 2015 calendar year and 30 for years thereafter).

The second scenario occurs when an employer does provide health coverage that is “minimum essential coverage” to its employees, but that coverage is deemed inadequate for Employer Mandate purposes, either because it is not “affordable,” it does not provide at least “minimum value,” or the employer offers coverage to substantially all (but not all) of its full-time employees and one or more of its full-time employees both enrolls in Exchange coverage and receives an Exchange subsidy. In this second scenario, the employer will owe an “inadequate coverage penalty.” The inadequate coverage penalty is $3,000 per year (also adjusted for inflation after 2014) and is calculated based, not on the employer’s total number of full-time employees (as is the case for the no coverage penalty), but only on each full-time employee who receives an Exchange subsidy. Furthermore, the penalty is capped by the maximum potential “no coverage penalty” discussed above.

2. Contingent Workers and the Employer Mandate

Under the Employer Mandate, the term “employee” means a common law employee. An individual who provides services to an employer is a common law employee if the employer has the authority to direct and control the manner in which services will be performed by the employee. Employee status is a facts and circumstances determination. Therefore, employers with contingent workers should be aware of what may happen if the IRS takes the position that the contingent workers are, in fact, the employer’s common law employees.

In the context of employment taxes, employers may be afforded relief from liability under section 530 of the Revenue Act of 1978 for misclassifying an individual as an independent contractor, unless the employer had no reasonable basis for not treating the individual as an employee. The preamble to the final Employer Mandate regulations, however, makes clear that similar relief is NOT available with respect to worker misclassification in the context of liability for the Employer Mandate penalty. Thus, if workers who were treated as independent contractors (or employees of another entity, like a leasing organization) and not offered health coverage by an employer, are later reclassified as employees of the employer for past periods, and those workers had sufficient hours of service to be full-time employees for such past periods, the reclassification may impact whether the employer is subject to the play or pay penalty. If the reclassified workers result in 5% or more of the employer’s total number of full-time employees for one month or more not having been offered health coverage, the reclassification could cause the employer to be liable for a penalty for failing to offer coverage to substantially all of its full-time employees. In addition, even if the reclassified workers are a very small fraction of the
employer’s full-time work force, the employer could still be liable for a penalty for a particular reclassified employee if that employee worked full-time and received a federal premium tax credit to help pay for coverage purchased through an Exchange.

3. Protection Against Adverse Consequences of Misclassification

Employers can protect themselves from the risk that reclassification of contingent workers could trigger an Employer Mandate penalty by hiring contingent workers through a staffing firm that offers coverage to the workers it places with the employer and charges a higher fee for contingent workers who elect such coverage. Under IRS regulations, if an offer of health coverage is made by a staffing firm that places the worker with the employer, the offer will be treated as made by the employer, but only if the employer pays a higher fee to the staffing firm for an individual enrolled in the health coverage than the employer would pay the firm for the same individual if he or she were not enrolled in the staffing firm’s health coverage. The employer will get credit for the offer of coverage regardless of whether the worker takes the coverage. If the IRS reclassifies the worker placed by the staffing firm as an employee, the offer of coverage will ensure that the employer has met the requirement to offer to substantially all of its employees and prevent misclassification from triggering a penalty in the first scenario. The coverage can also protect against a penalty in the second scenario, but only if it is affordable and provides minimum value.

To implement this strategy, employers will need to review their contracts with staffing firms to include necessary agreements on offers of health coverage and to provide mechanisms that allow the employer to verify that coverage is being offered as promised. Employers will also have to pay slightly more for contingent workers who accept coverage from the staffing firm to comply with the rule, although it appears that an additional payment of any amount will satisfy the requirement.

I. Unemployment Insurance

Worker eligibility for unemployment benefits requires an employment relationship. For purposes of unemployment insurance, “employment” is defined as “service, including service in interstate commerce, performed by an employee for wages or under any contract of hire, written or oral, express or implied.” Unemp. Ins. Code § 601.

1. Independent Contractors

California’s Unemployment Insurance Code expressly provides that common law rules for determining the existence of an employer-employee relationship are applied. Unemp. Ins. Code § 606.5(a); Southwest Research Inst. v. Unemployment Ins. Appeals Bd., 81 Cal. App. 4th 705 (2000). Accordingly, independent contractors are not entitled to unemployment benefits. For example, in Southwest Research, a corporation challenged a decision by the Unemployment Insurance Appeals Board that the corporation’s vendor was an employee for unemployment insurance purposes. Applying the common law test discussed above, the court found that the vendor was an independent contractor and not an employee entitled unemployment benefits. As a result, the corporation was not liable for any unemployment compensation benefits.
2. Temporary Employees supplied by staffing agencies

Client employers may not be required to obtain unemployment insurance for temporary employees obtained through a staffing agency, because a “leasing employer” or “temporary services employer” that contracts to supply employees to perform services for a customer or client is the employer of the employees who perform the services. Unemp. Ins. Code § 606.5(c). A “temporary services employer” and a “leasing employer” is defined as “an employing unit that contracts with clients or customers to supply workers to perform services for the client or customer” and performs all of the following functions: (1) negotiates with clients or customers for such matters as time, place, type of work, working conditions, quality, and price of the services; (2) determines assignments or reassignments of workers, even though workers retain the right to refuse specific assignments; (3) retains the authority to assign or reassign a worker to other clients or customers when a worker is determined unacceptable by a specific client or customer; (4) assigns or reassigns the worker to perform services for a client or customer; (5) sets the rate of pay of the worker, whether or not through negotiation; (6) pays the worker from its own account or accounts; and (7) retains the right to hire and terminate workers. Unemp. Ins. Code § 606.5(b). Accordingly, a staffing agency will only be considered the employer for unemployment insurance purposes, if it meets all of the above criteria.

J. Workers’ Compensation Insurance

Every employer is required to maintain workers’ compensation insurance. Lab. Code § 3700. However, an employer is only liable for injuries sustained by its employees in the course of their employment. Lab. Code § 3600. Accordingly, employers are not liable for injuries sustained by independent contractors. Lara v. Workers’ Compensation Appeals Bd., 182 Cal. App. 4th 393 (2010). In Lara, a gardener that was injured while pruning bushes for a diner, challenged the Workers’ Compensation Appeals Board’s decision that he was not entitled to workers’ compensation benefits because he was an independent contractor. Applying the common law test discussed above, the court also concluded that the gardener was an independent contractor exempt from workers’ compensation coverage.

As mentioned above, Labor Code Section 2810.3(b)(2) now imposes joint liability on employers for a labor contractor’s failure to secure valid workers’ compensation coverage for workers supplied by the labor contractor. Accordingly, client employers will be liable for injuries suffered by temporary employees supplied by a staffing agency, if the agency fails to maintain coverage for its employees.

K. Employment Status Under OSHA

An employer for the purposes of the Occupational Safety and Health Act is defined as “a person engaged in a business affecting interstate commerce who has employees,” and an employee is defined as “an employee of an employer who is employed in a business of his employer which affects interstate commerce.” 29 U.S.C. 652(5), (6). Under OSHA and its related regulations, any employer must record the injuries and illnesses or all its employees, whether the employee is classified as labor, executive, hourly, salaries, part-time, seasonal or migrant workers. 29 CFR 1904.31. Even if a worker is not on an employer’s payroll, the employer must record all injuries and illnesses of any employee they supervise on a daily basis.
1. Temporary Workers

As to temporary workers, staffing agencies and host employers are jointly responsible for maintaining a safe work environment. This includes providing OSHA training, hazard communication, and fulfilling record keeping requirements. Both employers must consider its position to prevent and correct violations of OSHA; the DOL suggests that staffing agencies might be in a better position to provide general safety and training, while a host employer should provide specific training tailored to a particular workplace. For this reason, staffing agencies have a duty to inquire into the conditions of the worker’s assigned workplaces, and verify that the host has fulfilled its responsibilities for a safe workplace.

2. Multi-Employer Citations

Where there are multiple employers on a worksite, more than one employer may be citable for a hazardous condition that violates OSHA. First, it must be determined whether the employer is a “creating, exposing, correcting, or controlling employer.” A “creating” employer is the one that cause the hazardous condition; an “exposing” employer is one whose own employees are exposed to the hazard; a “correcting” employer is one who engaged in a common undertaking, on the same worksite, as the exposing employer, and is reasonable for correcting the hazard; a “controlling” employer is one who has a general supervisory authority over the worksite.

If the employer falls into any of these categories, it has obligations under OSHA. Next, it must be determined whether the employer fulfilled those obligations. This will be dependent on which category the employer falls into. A “creating” employer is citable even if the only employees harmed are those of the other employers on the site. An “exposing” employer, who did not himself create the hazard, is citable if it (1) knew of the hazard or failed to exercise reasonable diligence to discover the hazard, and (2) failed to take steps to protect its employees. A “correcting” employer must exercise reasonable care in preventing and discovering violations, and meet its obligations in correcting the hazard. A “controlling” employer must exercise reasonable care to prevent and detect violations on the site.

IV. RECOMMENDATIONS

As these materials demonstrate, employers are confronted with numerous legal risks when using contingent workers. That alone is troublesome for employers. However, with increased usage of contingent workers has come increased scrutiny, from both legislators and regulators, of these non-traditional employment relationships. For the uninformed employer, this can lead to significant liability. Nevertheless, employers can take precautions to reduce and manage the risks associated with contingent workers.

A. Staffing Agencies

- Try to limit the use of staffing agencies to work that is not a part of your day-to-day business operations.

- Limit the length of time contingent workers will be used.
• If possible, have staffing agency work performed off site (i.e., not on your premises) or have the temporary agency supervise its workers at your location.

• Review existing contracts, especially indemnity provisions, and negotiate new agreements.

• Outsource entire functions or projects, rather than just workers.

• Clarify responsibilities and avoid becoming involved in a staffing agency’s hiring, firing, training or supervision of the workers that it provides.

• Limit control only to results of work, not day-to-day activities.

• In staffing agreements, specify the occurrences for indemnification (e.g., breach of representations and warranties regarding compliance with labor laws).

• Require the staffing agency to maintain workers compensation insurance that covers all workers it provides.

• Review employee benefits plans and employment policies to determine if they cover contingent workers. If you intend to exclude them, be sure that the language of the documents is adequate.

• Limit interaction between regular employees and contingent workers.

• Train your employees and management how to interact with contingent workers, stressing that the contingent workers should not be treated as if they were employees (e.g., do not provide contingent workers with the company’s employee handbook; issue them separate access badges or identification; direct any complaints from the contingent worker back to the agency (although in some cases, the company itself should investigate a complaint by a contingent worker if the contingent worker is complaining about a company employee)).

B. Independent Contractors

• Do not rely on a contract alone to define the relationship.

• Limit control only to results of work, not manner and means of completing.

• Do not retain the power to terminate or supervise day-to-day activities.

• Pay by the job, not by the hour.

• Require contractor to use its own tools and equipment.

• Ensure contractor has other work/clients.

• Require that any independent contractor have necessary licenses.
• Avoid independent contractor relationships with individuals; it is easier to establish an independent contractor relationship with a corporate entity or limited liability company, especially if it is not a one-person entity.

• Avoid requiring that an “independent contractor” wear the company uniform, adhere to a set schedule, be assigned to a specific “route” or location, and avoid requiring use of periodic reports or forms that would be required of an ordinary employee.

• Never have “independent contractors” who are performing the same duties as employees.

• Avoid using a former employee as a “consultant” simply because the employee has retired or left the company; consider making that person a temporary employee using a written, temporary employment agreement.

• Review employee benefits plans and employment policies to determine if they cover contingent workers. If you intend to exclude them, be sure that the language of the documents is adequate.

• Limit interaction between employees and independent contractors.

• Train regular employees and management how to interact with contingent workers, stressing that they are not to be treated as employees.

C. Insurance Coverage

• If using a staffing agency or a third-party contractor, require the agency or a third-party contractor to maintain liability insurance (with coverage for employment practices liability if that can be negotiated).

• Advise your own insurance broker if you have employees from a staffing agency on site with your own employees.

• Follow suggestions above for Independent Contractors to avoid establishing a common law employment relationship.

• To avoid having to maintain unemployment insurance for temporary employees, ensure staffing agency (1) negotiates with clients or customers for such matters as time, place, type of work, working conditions, quality, and price of the services; (2) determines assignments or reassignments of workers, even though workers retain the right to refuse specific assignments; (3) retains the authority to assign or reassign a worker to other clients or customers when a worker is determined unacceptable by a specific client or customer; (4) assigns or reassigns the worker to perform services for a client or customer; (5) sets the rate of pay of the worker, whether or not through negotiation; (6) pays the worker from its own account or accounts; and (7) retains the right to hire and terminate workers.
• Require staffing agency to represent and warrant in contract that it maintains valid workers’ compensation insurance for its employees. If you have any doubts about the agency, demand to see proof of its workers’ compensation insurance.

• Specifically reference a staffing agency’s failure to maintain valid workers’ compensation insurance with respect to indemnification provision of contract.

D. Parent/Subsidiary Relationships

• Avoid a parent/subsidiary relationship where the parent has no employees at all (as in the Castaneda case).

• Allow the subsidiary to function independently.

• Avoid common management between parent and subsidiary, or affiliated other companies involved in subsidiary’s operations.

• Parent should avoid exercising control over subsidiary’s operations or employees.

• Subsidiary should have its own employment policies and procedures.

• Parent should avoid participating in hiring, firing, training, supervision or discipline.

• Parent should not administer employee benefit plans.

• Parent should not be responsible for the payroll function of the subsidiary.

• Interaction between “corporate” human resource staff and subsidiary’s human resource staff is a difficult question. In general, allow the subsidiary’s human resource staff to function independently. However, there may be occasions where the parent needs to be involved.

V. CONCLUSION

A prudent employer will follow closely the developments in this area of law: in the next year or two there should be significant decisions from the California Supreme Court, the federal courts and various administrative agencies. One major decision of the National Labor Relations Board will eventually be reviewed by the federal courts of appeal. Further, legislatures on both the state and federal level are likely to adopt additional legislation that will affect the relationship of employers and labor contractors. Last, it is unknown at present how, or even if, the Trump Administration will view these issues and whether it will seek to reverse some of the initiatives of the Obama Administration.