

Chapter 1

The Regulation of Employment

Chapter Objective

The student is introduced to the regulatory environment of the employment relationship. The chapter examines whether regulation is actually necessary or beneficial or if, perhaps, the relationship would fare better with less governmental intervention. The concepts of “freedom” to contract in the regulatory employment environment and non-compete agreements are discussed. Since the regulations and case law discussed in this text rely on an individual’s classification as an employer or an employee, those definitions are delineated and explored.

Learning Objectives

(Click on the icon following the learning objective to be linked to the location in the outline where the chapter addresses that particular objective.)

At the conclusion of this chapter, the students should be able to:

1. Describe the balance between the freedom to contract and the current regulatory environment for employment. 
2. Identify who is subject to which employment laws and understand the implication of each of these laws for both the employer and employee. 
3. Delineate the risks to the employer caused by employee misclassification. 
4. Explain the difference between an employee and an independent contractor and the tests that help us in that determination. 
5. Articulate the various ways in which the concept “employer” is defined by the various employment-related regulations. 
6. Describe the permissible parameters of non-compete agreements. 

Detailed Chapter Outline

Scenarios—Points for Discussion

Scenario One: This scenario offers an opportunity to review the distinctions between an employee and an independent contractor discussed in the chapter (Refer to “The Definition of Employee,” particularly Exhibits 1.3–1.5). Discuss the IRS 20-factor analysis, as it applies to Dalia’s position. In light of the low level of control that Dalia had over her fees and her work process, and the limits upon her choice of clients, students should come to the conclusion that Dalia is an employee (therefore, eligible to file an unemployment claim), rather than an independent contractor.

Scenario Two: Soraya would not have a cause of action that would be recognized by the EEOC. Review the section “The Definition of ‘Employer’” with students, and discuss the rationale that determines the status of a supervisor vis-à-vis anti-discrimination legislation. Because Soraya is Soraya’s supervisor, not her employer, he cannot be the target of an EEOC claim of sexual harassment.

CCC, Soraya’s employer, would be vulnerable to an EEOC claim if the company lacked or failed to follow a system for employee redress of discrimination grievances. However, in this case, CCC appears to have a viable anti-discrimination policy that it adhered to diligently; consequently, Soraya would be unlikely to win a decision in her favor. The court in *Williams v. Banning* (1995) offered the following rationale for its decision in a similar case:

“She has an employer who was sensitive and responsive to her complaint. She can take comfort in the knowledge that she continues to work for this company, while her harasser does not and that the company’s prompt action is likely to discourage other would be harassers. This is precisely the result Title VII was meant to achieve.”

Scenario Three: Students should discuss whether or not Mya non-compete agreement is likely to be found reasonable by a court, and elaborate the aspects of the agreement that Mya might contest as unreasonable (refer to the section below, “Covenants Not to Compete”). Does Mya have a persuasive argument that the terms of her non-compete agreement are unreasonable in scope or duration? Might she have grounds to claim that the agreement prohibits her from making a living?

Given the diversity of state laws regulating non-compete agreements, discuss the range of legal restrictions that might apply to Mya’s particular agreement with her employer. As an employee who works across several states, Mya’s defense may depend upon the presence—and specific language—of a forum selection clause in her non-compete agreement. Consider what language would be more likely to provide Nan with a strong defense against the breach of contract claim.

Mya might also argue that the company’s client list is available through public means, and therefore, her access to this list should not be prohibited.

General Lecture Note for Employment Law Course

In order to teach this course, instructors have found that students must be made to feel relatively comfortable with their peers. Instructors will be asking the students to be honest and to stay in their truth, even at times when they feel that their opinion on one of these matters will not be popular or accepted by the group. In order to encourage an open atmosphere, it is therefore necessary for the class to feel comfortable with and to be aware of itself as a group. Here are two exercises, which have proven to be useful in reaching that goal in some classes:

Cultural Introductions

Have students sit in groups of four or five. Once they are in their groups (some instructors call them families, so as to prevent a feeling of competition), have students introduce themselves,

as well as provide a bit of cultural introduction (where they or their parents are from, where they may have lived, or other “cultural” information, like they are from the suburbs, or they work for a certain industry, or they went to a catholic school, etc.). They should also discuss times when they may have been more aware of this cultural difference than others. This will only be shared with the families. In this way, each student is made aware of the fact that she or he belongs to a number of different cultures, their gender, race, and ethnicity, as well as geography, age, type of education, etc. Generally “white males” is used as the concept of majority, though many of the “white males” in the class may belong to a variety of cultural groups. Allow each of them to understand their own uniqueness.

Then ask group members to introduce other members to the class.

Four Facts

Ask the students to get into groups and list four statements about themselves, three of which should be true, and one of which should be false. Also ask them to list below those statements the names of the members of their family. (The instructor should do this too, up on the board, then disclose later to the whole class.)

Now, each individual should take turns reading her or his statements to their family. As each person reads their statement, the other people should jot down which numbered statement is false next to their name.

Then, take one person at a time, and all of the others should identify which statement they believe is false and why. After everyone has made their guess, the person who shared the statements can reveal which is actually false.

- Were the students surprised at some of the facts that people shared? Which? Why?
- How good were the students, individually and as a group, at picking the false statement?
- What does this tell one about making assumptions and judgments about people?
- Were some of the statements given by different people similar? Why?

Give the following instructions to students to find out how many they got right—“Everyone stand up. If you got at least one right, stay standing. Two right, stay standing. Three right? Four right? Five right? etc.” Soon only one or two may remain standing.

Opening Discussion Tip

What is employment law?

How the law affects managers, management in general is what will be studied. This is important for one to know as employees and as potential employers. Now, one may not follow the law, but one should be aware of the ramifications of one’s management employment decisions. For instance, as an employee, one may know that one’s employer has no right to do something, but one submits to it anyway to avoid losing one’s job or having to go to court. As an employer, one may know that one’s actions are not legal according to the letter of the law, but one weighs the

costs and benefits and decides to do it anyway. Simply, one must know the law in order to weigh the costs!

There is now a knowledge gap among professionals since most managers and personnel practitioners have not had formal training in the application of new employment laws to the workplace. In addition, most lawyers may understand the law as it is applied to a business relationship, but not to employment relationships.

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Learning Objective One: Describe the balance between the freedom to contract and the current regulatory environment for employment.

I. Introduction to the Regulatory Environment

Lecture Note: Just a tip to get the students to open their eyes a bit to the new ideas that may be presented in this course. Ask the students to clasp their hands (interlock the fingers). Then ask them to look down and see which thumb is on top. Tell them to unlock them and to do it again. Look down. How many students clasped their hands differently? Probably none or very few. Now ask them to try to clasp them with the other thumb on top. It feels different, doesn't it? However, there is no reason in the world why it should feel any differently, except that one is used to doing it one way and not the other. Why do they think they clasp the one way in the first place? "Are you the type of person who goes right back to what is comfortable once you have changed for a moment, or are you the type of person who stays with a new idea to see if you like it, how it feels?" The purpose of this exercise is to show students that they should be open to new ways of looking at things, even if at first they feel a little uncomfortable.

If an employer wants to hire someone to work every other hour every other week, it should be allowed to do that, as long as it can locate an employee who wants that type of job. The freedom to contract is crucial to freedom of the market; an employee may choose to work or not to work for a given employer, and an employer may choose to hire or not to hire a given applicant.

It is unlikely that Congress would enact legislation that would require employers to hire certain individuals or groups of individuals (like a pure quota system) or that would prevent employers and employees from freely negotiating the responsibilities of a given job. (Refer to Exhibit 1.1, *Realities about the Regulation of Employment*.)

Employers historically have had the right to discharge an employee whenever they wished to do so. However, Congress has passed employment-related laws when it believes that there is some imbalance of power between the employee and the employer. For example, Congress has passed laws that require employers to pay minimum wages and avoid using certain criteria such as race or gender in reaching specific employment decisions. These laws reflect the reality that employers stand in a position of power in the employment relationship. Legal protections granted to employees seek to make the "power relationship" between employer and employee one that is fair and equitable.

A. Is Regulation Necessary?

There are scholars who do not believe that regulation of discrimination and other areas of the employment relationship is necessary. Proponents of this view believe that the market will work to encourage employers' rational, nonbiased behavior.

Some economists have argued that rational individuals interested in profit maximization will never hesitate to hire the most qualified applicants, regardless of their race. Decisions that are dependent on race or gender would be inefficient, they argue, since they are based on the (generally) incorrect belief that members of one class are less worthy of a job than those of another. Therefore, they will not let prejudices cause them to hire less qualified individuals and employ a less efficient workforce.

However, opponents of this position contend that discrimination continues because often employers are faced with the choice of two *equally* qualified applicants for a position. In that case, the prejudiced employer suffers no decrease in efficiency of her or his firm as a result of choosing the white or male applicant over the minority or female applicant. In addition, human beings do not always act rationally or in ways that society might deem to be in the best interests of society, as a whole. Finally, given the composition of the work force, if a biased firm chooses only from the stock of white males, it still might have a pretty qualified stock from which to choose; so it can remain awfully competitive. Therefore, economic forces do not afford absolute protection against employment discrimination where the discrimination is based on race, gender, national origin, or other protected categories.

Lecture Notes:

- One example that could be used by professors in class is to inform students that, generally, an employer may choose not to hire anyone who is blonde. Hair color is not a protected class and decisions on that basis are legal, as long as they do not have an adverse impact. (One may want to note that the opposite rule may have an adverse impact. If one was to hire *only* blondes, this rule may have a disparate impact on Blacks or Asians.)
- This might be a good place to stop and discuss Exhibit 1.1, *Realities about the Regulation of Employment*. How many students believe these “realities?” Why? Have they had any experience with any of these issues? Is there a difference in connection with these realities between what the law says and how it is implemented in the work place?
- After they have done the reading, it is helpful to ask several students to argue that regulation is absolutely necessary in order to bring about equality of opportunity, then pose them against several other students who argue the other side.

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Learning Objective Two: Identify who is subject to which employment laws and understand the implication of each of these laws for both the employer and employee.

B. Who Is Subject to Regulation?

The issue of whether someone is an employer or employee is a critical one when it comes to regulation, but like many areas of the law, it is not one with an easy answer. (Refer to Exhibit 1.2, *Realities about Who Is an Employee and Who Is Not*.) Defining an individual as an employee allows that person to pursue a claim that an independent contractor might not have.

C. Origins in Agency Law

The law relating to the employment relationship is based on the traditional law called *master and servant*, which evolved into the law of agency. In an agency relationship, one person acts on behalf of another. The actor is called the *agent*, and the party for whom the agent acts and from whom that agent derives authority to act is called the *principal*. The agent is basically a substitute appointed by the principal with power to do certain things. In the employment context, an employee is the agent of the employer, the principal.

In an employment—agency relationship, the employee—agent is under a specific duty to the principal to act only as *authorized*. As a rule, if an agent goes beyond her authority or places the property of the principal at risk without authority, the principal is now responsible to the third party for all loss or damage naturally resulting from the agent's unauthorized acts (while the agent remains liable to the principal for the same amount).

Throughout the entire relationship, the principal/employer has the obligation toward the agent to exercise good faith in their relationship, and the principal has to use care to prevent the agent from coming to any harm during the agency relationship. This requirement translates into the employer's responsibility to provide a safe and healthy working environment for the workers.

D. Why Is It Important to Determine Whether a Worker Is an Employee?

How does one know if one is being hired as an employee or as an **independent contractor**? While some workers may have no doubt about their classification, the actual answer may vary, depending on the statute, case law, or other analysis to be applied. The courts, employers, and the government are unable to agree on one definition of "employee" and "employer," so it varies, depending on the situation and the law being used. In addition, some statutes do not give effective guidance.

The definition of employee is all the more important as companies hire supplemental or contingent workers on an independent-contractor basis to cut costs. Generally, an employer's responsibilities increase when someone is an employee.

Employer Payroll Deductions

An employer paying an employee is subject to requirements different from those for paying an independent contractor. An employer who maintains employees has the responsibility to pay Social Security (FICA), the FICA excise tax, Railroad Retirement Tax Act (RRTA) withholding amounts, federal unemployment compensation (FUTA), IRS

federal income tax withholdings, Medicare, and state taxes. In addition, it is the employer's responsibility to withhold a certain percentage of the employee's wages for federal income tax purposes.

On the other hand, an independent contractor has to pay all of these taxes on his or her own. This is usually considered to be a benefit for the employer because it is able to avoid the tax expenses and bookkeeping costs associated with such withholdings.

Benefits

Benefits cost the employer money outside of the wages that the employer must pay the employee. In an effort to attract and retain superior personnel, employers offer employees a range of benefits that generally are not required to be offered such as dental, medical, pension, and profit-sharing plans. Independent contractors have no access to these benefits.

Note: Actually, under the ACA (otherwise known as “Obamacare”), employers with 50 employees or more are required to provide some form of healthcare to employees. This requirement might change in the future, depending on changes that might be made by Congress.

The Fair Labor Standards Act of 1938 was enacted to establish standards for minimum wages, overtime pay, employer record keeping, and child labor. Where a worker is considered an employee, the FLSA regulates the amount of money an employee must be paid per hour and overtime compensation. Employers may intentionally misclassify employees in order to avoid these and other costs and liabilities. A willful misclassification under FLSA may result in imprisonment and up to a \$10,000 fine, imposed by the Department of Labor. A second violation could lead to imprisonment.

Discrimination and Affirmative Action

Title VII and other related antidiscrimination statutes only protect *employees* from discrimination by employers; therefore, an independent contractor cannot hold an employer liable for discrimination on this basis and employers are protected from some forms of discrimination and wrongful discharge claims where the worker is an independent contractor.

Merely labeling a worker as an “independent contractor” does not protect against liability under federal antidiscrimination statutes such as Title VII. Courts and the EEOC will examine a variety of factors to determine the true meaning of the relationship between the worker and the organization. If the worker is more appropriately classified as an employee, then the label will be peeled off, allowing for antidiscrimination statutes to apply.

Additionally, the National Labor Relations Act of 1935 (NLRA) protects only employees and not independent contractors from unfair labor practices. Independent contractors may be considered to be *employers*; so they may be subject to these regulations from the other side of the fence.

Cost Reductions

It would seem to be a safe statement that an objective of some, if not most, employers is to reduce cost and to increase profit. Hiring independent contractors avoids the cost of overtime (the federal wage and hour laws do not apply to independent contractors) and the employer is able to avoid any work-related expenses such as tools, training, or traveling. The employer is also guaranteed satisfactory performance of the job for which the contractor was hired because it is the contractor's contractual obligation to adequately perform the contract with the employer, while the employee is generally able to quit without incurring liability (the at-will doctrine). If there is a breach of the agreement between the employer and the independent contractor, the independent contractor not only stands to lose the job but also may be liable for resulting damages. An employee is usually compensated for work completed with less liability for failure to perfectly perform.

The employee may actually cause the employer to have greater liability exposure. An employer has **vicarious liability** if the employee causes harm to a third party while the employee is in the course of employment. Questions might arise in connection with whether the worker is actually an employee of the employer and, therefore, whether the employer is liable at all. However, in certain situations, businesses will be liable for the acts of their independent contractors, including when those contractors are involved in "inherently dangerous activities."

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Learning Objective Three: Delineate the risks to the employer caused by employee misclassification.

The Cost of Mistakes

Workers and employers alike make mistakes about whether a worker is an independent contractor or an employee. If a worker is classified as an independent contractor but later is found to be an employee, the punishment by the IRS is harsh. The employer is not only liable for its share of FICA and FUTA taxes but is also subject to an additional penalty equal to 20 percent of the FICA taxes that should have been withheld. In addition, the employer is liable for 1.5 percent of the wages received by the employee. These penalty charges apply if 1099 forms (records of payments to independent contractors) have been compiled for the worker. If, on the other hand, the forms have not been completed, the penalties increase to 40 percent of the FICA taxes and 3 percent of wages. Where the IRS determines that the worker was *deliberately* classified as an independent contractor to avoid paying taxes, the fines and penalties can easily run into six figures for even the smallest business.

The U.S. Department of Labor launched a major Misclassification Initiative and works in cooperation with the Internal Revenue Service, to reduce the incidence of employee misclassification and to improve compliance with federal labor laws. In addition, the DOL

has signed memoranda of understanding with 45 states to share information and coordinate enforcement efforts on the federal level, Payroll Fraud Prevention Act of 2018 was (re)introduced in Congress, for the fourth time, since it did not make it out of committee during any of the prior processes.

Meanwhile, many states are searching for misclassifications through special task forces and asking for new legislation. Because of the tremendous costs to a state of misclassification, several states, including New Jersey, Colorado, and Louisiana, have passed aggressive laws to identify misclassification of independent contractors.

Misclassified workers are a significant portion of the employment tax gap, but just how big a portion is unknown, because the IRS's last comprehensive misclassification estimate was in 1984. At that time, the IRS found that 15 percent of employers misclassified 3.4 million workers as independent contractors, causing an estimated loss of \$1.6 billion in Social Security tax, unemployment tax, and income tax.

The IRS provides a small "safe harbor," called the Classification Settlement Program, through the 1978 Revenue Act for employers who have always and consistently defined a class of workers as independent contractors. Section 530 cites four criteria required to claim a worker as an independent contractor. Where these conditions have been satisfied, the employer is not liable for misclassification:

- The business must have never treated the worker as an employee for the purposes of employment taxes for any period.
- All federal tax returns with respect to this worker were filed consistently with the worker being an independent contractor.
- The company has treated all those in positions substantially similar to that of this worker as independent contractors.
- The company has a reasonable basis, for treating the worker as an independent contractor, which may include a judicial precedent or published IRS ruling, a past IRS audit of the company, or long-standing industry practices.

In 2011, the IRS introduced the Voluntary Classification Settlement Program, which enables employers who are not currently subject to examination by the IRS, DOL, or a state agency to voluntarily reclassify their workers and to obtain substantial relief from federal payroll taxes, interest, and penalties. In both programs, the employer must agree to treat workers as employees prospectively.

Lecture Note: It should be emphasized that each student is a unique individual. Even in a class where these types of issues are "on the table," students, of course, retain their biases from their culturalization process. In an effort to break these molds, instructors could play a game called Human Bingo. The purpose of this game is to make students aware that people are not always who one thinks they are, and that the one person in the class who appears to be the most reserved may also be the only person in the class who has jumped out of an airplane, or who speaks several languages, and so on.

Prepare a grid on a regular sheet of paper with twenty-five boxes. Fill in twenty of the boxes with qualities such as “speaks more than two languages,” “has skydived before,” “knows a good joke and can tell it,” “can name at least three Michael Jackson songs,” “grew up in the city/suburbs,” etc. Copy these sheets so that everyone has the same one and hand them out.

Tell students to write a quality that an individual may have in each of the empty squares. This can be: skis downhill, reads People, lives more than thirty miles from school, can name three Michael Jackson songs, etc. The trick to listing these is that the quality must be one that the instructor expects less than half of the class to satisfy.

The point of this exercise is to walk around the room and find people who satisfies that quality. The instructor may only ask, do you..., not whether they can sign any of the boxes. If they do, have them sign that square on the instructor’s sheet. The instructor should collect as many signatures as she/he can. At the end of the time limit, the person who has the most bingo lines on their paper wins. Ties will be broken by the total number of squares signed. And those ties will be broken by the students voting on which of them listed the harder qualities to find.

[The instructors could ask who signed certain boxes, and ask the person who knows the joke to tell it, the person who knows the songs to name them, etc.]

II. The Definition of “Employee”

Courts have offered various ways to determine whether a worker is an employee. Generally, the interpretation used depends on the factual circumstances presented by each case, as well as which law is at issue.

Several tests have been developed and are commonly used by courts to classify employees and independent contractors. These tests include the common-law test of agency, which considers several factors but focuses on who has the right to control the work; the Internal Revenue Service (IRS) 20-factor analysis; and the economic realities analysis. Several courts also use a hybrid approach, using one test that combines factors from other tests. As the court explains in *Murray v. Principal Financial Group, Inc., et al.*, the three tests are functionally equivalent with the common-law test controlling.



Opinion Letter from Acting Administrator- US Department of Labor

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Learning Objective Four: Explain the difference between an employee and an independent contractor and the tests that help us in that determination.

Under what is now considered to be the leading test to determine status, the **common-law agency test**, a persuasive indicator of independent-contractor status, is the ability to control how the work is performed. This test originated in the master and servant law. Using the language of

those origins, since the master (employer) had control over the servant (worker), the servant was considered similar to common-law property of the master and, therefore, originally governed by property law rather than contract law.

Under the common-law agency approach applied by the courts, the employer need not actually control the work but must merely *have the right or ability* to control the work for a worker to be classified an employee. The common-law test is specifically and consistently used to determine employee status in connection with employment taxes, as well as in federal income tax withholding.

The IRS does have a secondary analysis, called the **IRS 20-factor analysis** however, even the IRS itself explains that “this Twenty Factor Test is an analytical tool and *not* the legal test used for determining worker status. The legal test is whether there is a right to direct and control the means and details of the work.”

The following 20 factors have been continually articulated by courts, regulatory agencies, commentators, and scholars as critical to the determination of the status of an individual worker. When these factors are satisfied, courts are more likely to find “employee” status. The twenty factors are as follows:

- *Instructions*
- *Training*
- *Integration*
- *Personal rendering of services*
- *Hiring, supervising, and paying of assistants*
- *Continuing relationships*
- *Set hours of work*
- *Full-time requirement*
- *Work performed on the employer’s premises*
- *Order or sequence set*
- *Oral or written reports*
- *Furnishing of tools and materials*
- *Payment by hour, week, or month*
- *Payment of business or traveling expenses*
- *Significant investment*
- *Realization of profit or loss*
- *Work performed for more than one firm at a time*
- *Service made available to the general public*
- *Right to discharge*
- *Right to terminate*

Under the *economic realities test*, courts consider whether the worker is economically dependent on the business or, as a matter of economic fact, is in business for himself or herself. As noted previously, the economic realities test was recently updated.³⁹ The test considers all the following items to determine if the worker is in business for themselves (independent contractor) or is instead economically dependent on an employer for work (employee); (1) What is the nature and degree

of the worker's control over the work? (2) What is the worker's opportunity for profit or loss based on initiative, investment, or both? (3) What is the amount of skill required for the work? (4) What is the degree of permanence of the working relationship between the individual and the potential employer? (5) Is the work part of an integrated unit of production? While in the past all of these factors are considered as a whole with none of the factors being determinative, the new ruling effective March 2021 puts greater emphasis on items (1) and (2).

In *Juino v. Livingston Parish Fire District No. 5*, a volunteer firefighter faced sexual harassment at her station. The court chose to consider whether she was paid as the threshold test in determining whether she was an employee. Though Juino received some indirect benefits from her volunteer work (e.g., life insurance), the court ruled that they were not significant enough to pass this first test of employment.

Lecture Notes:

- It may be beneficial to ask the class whether they understand why an employer might want to classify someone as an employee. (In one case cited in the text, *Lemmerman*, an employer sought that classification because the plaintiff would then be limited to collecting damages under Workers' Compensation Act rather than under standard tort law.) Perhaps ask the class to list those reasons why some employers might classify someone as an employee or not.
- This would be a good time to review exhibit 1.3: An attorney is a sole practitioner who rents office space and pays for the following items: telephone, computer, on-line legal research database, fax machine, and photocopier. The attorney buys office supplies and pays bar dues and membership dues for three other professional organizations. The attorney has a part-time receptionist who also does the bookkeeping. The attorney pays the receptionist, withholds and pays federal and state employment taxes, and files a Form W-2 each year. For the past two years, the attorney has had only one client, a corporation with which there has been a long-standing relationship. The attorney charges the corporation an hourly rate for services and sends monthly bills detailing the work performed for the prior month. The bills include charges for cell phone bills, on-line research time, fax charges, photocopies, mailing costs, and travel costs for which the corporation has agreed to reimburse.
 - **Answer:** This list is not all-inclusive.

Employee

Neutral Value

Independent Contractor

Single Client

Paid by the hour

Hired secretary

Reimbursed for expenses

No financial contract

Payment of bar dues

Opportunity of profit or loss

Direction

Economic independence

- The attorney could be an independent contractor even though at the beginning independent contractor status is clear but at the end it is less clear. It is not clear that the attorney is an employee even with the addition of the last fact.

A. Contingent or Temporary Workers

As used by the EEOC, the term *contingent worker* includes those who are hired by an employer through a staffing firm, as well as temporary, gig work, seasonal, and part-time workers, and those considered to be independent contractors rather than employees.

Although contingent or temporary workers provide a cost savings as a short-term benefit, depending on their classification they could be entitled to protection under employment laws. It is important to be sure the classification given is the true classification.

B. Interns, Trainees and Volunteers

The last several years have seen a rise in cases filed by unpaid interns who claimed they were improperly designated "trainees" (and thus exempt from minimum wage and overtime protections), when, in fact, they should have been treated as paid employees under the FLSA and applicable state laws. The stakes in such cases can be substantial.

To decide whether interns, students and trainees qualify as "employees" for purposes of wage and hour requirements, courts typically rely on multifactor tests.. These may vary by jurisdiction but most focus on whether the nature of the relationship is educational, the economic reality of the relationship, and who primarily benefits from the work.

True volunteers are generally not considered employees, but there are caveats. The Department of Labor states that, "[i]ndividuals who volunteer or donate their services, usually on a part-time basis, for public service, religious or humanitarian objectives, not as employees and without contemplation of pay, are not considered employees of the religious, charitable or similar non-profit organizations that receive their service."

C. Joint Employers and Staffing Firms

Title VII prohibits staffing firms from illegally discriminating against workers in assignments and opportunities for employment. Staffing firms can be considered to be employers, as well, such as when they pay the worker and provide training and workers' compensation coverage.

If a client of a staffing firm supervises, trains, and otherwise directs the worker with whom it has a continuing relationship, then perhaps the client will become an employer of the worker. In this way, *both* the staffing firm *and* the client may share liability as employers of the worker. This is called *joint and several* liability, and the worker may collect compensatory damages from either one or both of the entities combined if a wrong is proven.

Whether a contingent worker who is placed by a staffing firm with the firm's clients qualifies as an employee depends on a number of factors, including whether the staffing firm or the client retains the right to control when, where, and how the worker performs the job and

whether there is a continuing relationship with the worker, among other factors. What is unique about the worker placed by a staffing firm is the potential for joint liability between the staffing firm and the client.

Further, employers may be held liable as “third-party interferers” under Title VII. For example, an employer using a staffing firm cannot avoid liability for discriminating against a temporary worker merely because it did not “employ” the worker.

D. Defining “Applicant”

Since federal regulations often require employers to track applicants on the basis of race, gender, and ethnicity, it is important to have a clear and consistent definition of who is an *applicant*. According to the EEOC’s Uniform Guidelines on Employee Selection Procedures (UGESP), while the precise definition depends upon the employer’s recruitment and selection procedures, in general it encompasses all individuals who indicate an interest in being considered for hiring, promotion, or other employment opportunities. This interest might be expressed by completing a written application form, or by expressing interest orally, depending upon the employer’s practice.

Technology has changed the way people apply for jobs and also has raised questions about who is an applicant in the Internet age. According to the U.S. Department of Labor Office of Federal Contract Compliance Programs, there are four criteria that define an Internet applicant:

- The individual submits an *expression of interest in employment through the Internet or related electronic data technologies*.
- The employer *considers* the individual for employment in a particular position.
- The individual’s expression of interest indicates the individual possesses the *basic qualifications* for the position.
- The individual *does not remove* himself from the selection process at any time prior to receiving an offer or otherwise indicate that he is *no longer interested in the position*.

Thus an e-mail inquiry about a job does not qualify the sender as an applicant, nor does posting a resume on a third-party job board.

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Learning Objective Five: Articulate the various ways in which the concept “employer” is defined by the various employment-related regulations.

III. The Definition of “Employer”

Depending on the applicable statute or provision, an *employer* is simply one who employs or uses others to do his or her work, or to work on his or her behalf. Most statutes specifically include in this definition employment agencies, labor organizations, and joint labor-management committees.

Issues may arise where an entity claims to be a private membership club (exempt from Title VII prohibitions) or a multinational company that may or may not be subject to application of various U.S. laws. A determination also must be made whether the employer receives federal funds or maintains federal contracts for coverage under the Rehabilitation Act of 1973, among others.

Another question is whether an individual, such as a supervisor, is also considered an employer under employment-related statutes and, therefore, can be held personally liable for her or his actions. Though most statutes are silent on the issue, the majority of courts have concluded that federal antidiscrimination statutes do *not* permit the imposition of this liability.

The most exacting issue is usually how many employees an employer must have in order to be subject to a given statute. It is crucial for employers to be familiar with the statutes to which they are subject and those from which they are immune. (Refer to Exhibit 1.6 for an overview of the various statutory definitions of employer.)

IV. The “Freedom” to Contract in the Regulatory Employment Environment

In the age of increasingly complex regulations governing the workplace, the relationship between employer and employee essentially is still based on an agreement. Terms and conditions of employment may be subject to regulation or open to contractual negotiation, and either expressed or implied. Though an employer is generally free to design contract terms of any kind, the terms and conditions set by an employer cannot violate the letter or the spirit of the applicable laws. Courts and legislatures sometimes determine that certain types of agreements between employer and employee are *unenforceable*.

LO

Learning Objective Six: Describe the permissible parameters of non-compete agreements.

V. Covenants Not to Compete (Non-Compete Agreements)

One employment constraint that has received varying degrees of acceptance by different states is the **covenant not to compete** or **non-compete agreement**. While individuals in positions of trust and confidence already owe a duty of loyalty to their employers during employment, even without a non-compete agreement, a non-compete agreement usually includes prohibitions against disclosure of trade secrets, soliciting the employer’s employees or customers, or entering into competition with the employer if the employee is terminated.

In July 2021, President Biden signed Executive Order 14036 on Promoting Competition in the American Economy.⁵⁸ This order directs the Federal Trade Commission and other federal agencies to draft their own rules regarding bans or limitations on non-compete agreements and unnecessary occupational licensing requirements that interfere with worker mobility. While most restrictions on non-compete agreements occurs at the state level, employers should pay attention to how the FTC will oversee and enforce the order.

All states allow employers *some* control over what information a former worker can use or disclose in a competing business and whether a former worker can encourage clients, customers, and former co-workers to leave the employer. However, not all states allow employers to prevent former workers from competing with them. States vary widely, from explicitly permitting non-compete agreements, to permitting agreements under certain circumstances, to strictly prohibiting agreements that limit for whom a former employee can work and where he or she can work.

In some states, certain professions are exempted from these prohibitions. For example, in certain states, prior employers can enforce non-competes against “management personnel” while they may not enforce the agreements against other types of workers. In many states, an employer may restrict a past employee based on location, length of time, and the type of work she or he may conduct, as long as the restrictions are reasonable and necessary to protect a business interest. Because of these state-by-state differences, it is critical to have **forum selection clauses** in contracts that stipulate the state law that will apply to the contract in question.

The common law generally *prohibits* the restriction if it is more broad than necessary to protect the employer’s legitimate interests or if the employer’s need is outweighed by the hardship to the employee and likely injury to the public.

To determine reasonableness, courts look to the location and time limitations placed on the employee’s ability to compete. The definition of competition under the non-compete agreement is also relevant. Restrictions that are for an indefinite period of time, or that prohibit the employee from working “anywhere in the United States,” would likely be considered unreasonable. However, as an example, restricting an employee from engaging in direct competition with the employer for one year from the end of their employment relationship within the same county may be considered reasonable. Generally, in order to be considered reasonable, the restrictive covenant should not prevent the employee from earning a living of any sort under its terms.

It is generally accepted that a valid restrictive covenant will meet the following qualifications:

- It protects a legitimate business interest.
- It is ancillary to a legitimate business relationship.
- It provides a benefit to both the employee and employer.
- It is reasonable in scope and duration.
- It is not contrary to the public interest.



***Osborne Assocs. v. Cangemi*, 2017 WL 5443146 (M.D. Fla. 2017)**

Covenants not to compete sometimes also include provisions with regard to trade secrets or confidentiality with regard to other elements of employer intellectual property. This property might also include, for instance, customer relations and goodwill, specialized training, or particular skills unique to the workplace. The agreement often depends on what an employer

considers to be trade secrets versus information in the public domain or commonly known in an industry. Confidential customer lists or customer preferences are often the source of trouble since they are usually maintained by individual workers based on professional relationships; however, most courts deem them property of the employer. Pricing, revenue, and other projections and marketing strategies are also commonly considered to be trade secrets. On the other hand, processes that are known by many in a particular industry or other information that is otherwise available through external sources are not considered to be company property. Customer lists, if accessible through public means, would therefore no longer fall under the rubric of trade secrets.

Under the theory of **inevitable disclosure**, employers are protected against disclosure of trade secrets even if no non-compete applies. A court may prohibit a former employee from working for an employer's competitor if the employer can show that there is imminent threat that a trade secret will be shared. The courts look to (1) whether the employee's knowledge is exceptionally specialized and technical, (2) which would give either business (former or new) a significant advantage in the market, and (3) the employee could perform her or his work without it. It might be highly unlikely, if not impossible, in some instances for some of these workers to conduct their work without disclosing the trade secret.

The Uniform Trade Secrets Act (UTSA) is a model act that strives to provide guidance to states developing statutes in this and other related areas. The UTSA provides relief in the form of monetary damages, attorney's fees, and injunctive relief for misappropriation of trade secrets and does include a provision for inevitable disclosure.

Once a non-compete agreement has been found to be valid, in order to be enforceable, it must also be supported by consideration offered in a bargained-for exchange. In other words, the agreement by the employee not to compete with the employer is *only* enforceable if the employee also receives something in exchange for this agreement. Often, non-competes are signed at the time an employee is first hired; so the offer of employment on its own is considered sufficient consideration. However, if an employee is asked to sign a non-compete agreement after being hired and is not offered any additional consideration, some states do not treat continued at-will employment as sufficient. It depends on the state in which the agreement is signed.

VI. Management Tips

- Always evaluate the status of the workers; do not assume employee or independent-contractor status for any worker.
- Employment status is relevant to employer payroll and other financial issues; therefore, misclassification may be costly to the employer.
- While an employer is not liable to independent contractors for discrimination based on Title VII, the independent contractor may have other causes of action. Therefore, hiring an independent contractor is not a safe harbor from liability.
- Monitor staffing firms with which one contracts for temporary or other contingent workers, are to ensure that the workers are being properly paid and that the firm provides workers' compensation coverage.

- Since statements in an employment policy manual may be construed in some circumstances as contractual promises, review all documentation as if one will be bound to it as a contract.
- Draft non-compete agreements that strive toward reasonableness.

Chapter-End Questions

1. Grace Cathedral Church owns a for-profit restaurant in Ohio called Cathedral Buffet. The buffet has both employees and volunteers that staff the restaurant. Volunteers perform many of the same restaurant-related tasks as employees: cleaning, washing dishes, serving cake, chopping vegetables, and manning the cash register. However, there is one meaningful distinction between employees and volunteers. Employees receive an hourly wage; volunteers do not. The Pastor often announces before his Sunday sermon that the buffet is short-handed and needs more volunteers from the parish, claiming it is the "Lord's Buffet," and that church members who repeatedly refuse to volunteer at the restaurant are at risk of "blaspheming against the Holy Ghost." The pastor never promises any compensation. Restaurant managers work around the volunteers' schedules, ensuring they are free during their assigned shifts. If you were the Sixth Circuit, would you find that the volunteers are employees or independent contractors? What variables would help you in reaching your decision? [*Acosta v. Cathedral Buffet, Inc.*, 892 F.3d 819 (6th Cir. 2018)]

Answer: The DOL argued that the restaurant violated the minimum-wage requirement of the Fair Labor Standards Act since the congregants weren't paid even though they were doing the same work as the regular paid employees. The district court in Ohio ruled in favor of the DOL following a bench trial, finding that the for-profit restaurant was not exempt from the FLSA or its minimum-wage requirement. A \$388,000 order against the restaurant was entered.

The Sixth Circuit reversed the district court. The court, citing Supreme Court precedent, held that "to be considered an employee within the meaning of the FLSA, a worker must first expect to receive compensation," finding that the parishioners in the case did not expect to be paid. "Put simply," the court wrote, "there was no economic relationship between the restaurant and the church member volunteers."

The DOL contended that the congregants were coerced into their volunteerism, overriding the fact that they had no expectation of payment for working in the restaurant. The court disagreed with the DOL's position. The court explained that "[t]he type of coercion with which the FLSA is concerned is economic in nature, not societal or spiritual," further finding that the FLSA was not intended to regulate "when, where, and how a person may volunteer her time to her church."

2. A staffing firm provides landscaping services for clients on an ongoing basis. The staffing firm selects and pays the workers, provides health insurance and withholds taxes. The firm provides the equipment and supplies necessary to do the work. It also supervises the workers

on the clients' premises. Client A reserves the right to direct the staffing-firm workers to perform particular tasks at particular times or in a specified manner, although it does not generally exercise that authority. Client A evaluates the quality of the workers' performance and regularly reports its findings to the firm. It can require the firm to remove a worker from the job assignment if it is dissatisfied. Who is the employer of the workers?

Students' answers will vary. Hence, the instructor should encourage students to have a class discussion. The employer of record is the staffing firm as would be expected with temporary agencies, but often this is classified as a joint employer situation.

3. Molly Freyer secured a rideshare with a Lyft driver, Rebecca Blaser. In the midst of the drive, Blaser became unconscious due to an illness. Freyer attempted to jump out of the car as it scraped a concrete divider. At the same time Blaser regained consciousness and accelerated the car, causing Freyer's foot to be pinned and dragged. Freyer needed her foot amputated and sought damages from both Blaser and Lyft. While Blaser settled with Freyer directly, Freyer's case against Lyft argued that because Blaser's liability insurance had lapsed, Lyft was liable because Blaser did not meet the conditions for being an independent contractor under the Transportation Networks Company (TNC) statutes. The liability insurance was in place when she began driving with Lyft and unbeknownst to her, her payment was not processed on time and the policy lapsed. Do you believe Lyft is liable? Explain. Do you think this case limits rideshare companies like Lyft or Uber from being responsible for vicarious liability for the independent contractor? [refer to *Freyer v. Lyft, Inc.*, 639 S.W.3d 772 (2021)]

Answer: The key determination is whether or not Blaser was an employee or an independent contractor. At this time, Lyft and Uber drivers are classified as independent contractors thus Blaser is personally liable, not Lyft. It does limit their liability. Students should debate who is actually liable.

4. ACD Emergency Road Services operates in Chicago, Illinois. They classify their employees as independent contractors. The following conditions are at play with the workers. ACD made deductions from workers' wages for vehicle damages, traffic tickets, uniforms and for failing to give a "timely" resignation notice. ACD also paid its hourly employees "straight time" for all the hours they worked, even if they exceeded 40 hours per week. Based on this information, do you believe that ACD hires employees or independent contractors?

Answer: The workers meet the classification of employee, not independent contractor. They are made to wear uniforms, are responsible for vehicle damage, and are penalized for not resigning with enough notice. An independent contractor is not required to give timely resignation notices, nor would they be required to wear uniforms or be fully directed by an employer. Because of this, the employees will be owed back overtime pay because they are misclassified.

5. Sandwich shop chain Jimmy John's was investigated by the New York and Illinois Attorneys General Offices for forcing their employees to sign a non-compete agreement. The non-compete agreement prohibited workers from working at any other business that sells

“submarine, hero-type, deli-style, pita, and/or wrapped or rolled sandwiches” within two miles of any Jimmy John’s shop in the United States during their employment and for two years thereafter. Jimmy John’s agreed to stop making their employees sign the agreements as part of a legal settlement. Illinois and New York are two states that seek to protect low wage workers from non-compete clauses. Why do you think some states are particularly concerned for low wage workers having to sign non-compete agreements? What are the strongest arguments in favor of employers, such as Jimmy John’s and others, being permitted to enforce non-compete clauses such as these?

Answer: Low wage workers often have less power and agency to find employment in the first place, without the added prohibition of a non-compete. Additionally, low wage workers are often low skill workers and as such are not conducting highly competitive and skilled services that would be harmful to a former employer. The common law generally *prohibits* the restriction if it is more broad than necessary to protect the employer’s legitimate interests or if the employer’s need is outweighed by the hardship to the employee and likely injury to the public. In this scenario, the hardship on these sandwich makers was unreasonable.

Arguments that might be made in favor of employers would have to do largely with intentional disclosure of practices and strategies that are trade secrets. For example, perhaps Jimmy John’s has a secret recipe for a sauce they make or a strategy for how fast they make their sandwiches. Those may be justifiably protected.

6. Licensed taxicab drivers in Boston brought an action against cab companies, alleging that they were misclassified by the companies as independent contractors. The taxicab drivers alleged that they were deprived of minimum wages, overtime pay, tips, and the protections afforded by the Wage Act.

In Boston, the commissioner is given the task of creating a comprehensive system of rules and regulations governing the ownership, leasing, licensing, rate setting, and operation of taxicabs in the city. In order for a qualifying taxicab to be put into service, the owner must obtain a license, called a “medallion,” for each such taxicab. There are myriad requirements that must be met in order to qualify for a medallion, including being deemed “suitable” individuals by the city’s inspector of carriages, obtaining adequate garage facilities within the city, and maintaining membership in an approved dispatch service or radio association, which provides twenty-four hour two-way communication solely, and exclusively, for Boston taxicabs. The radio associations, in turn, are required to provide certain enumerated dispatch services to their members and may accept payment for those services only from medallion owners.

Licensed taxicab drivers leased taxicabs and medallions from the medallion owners at flat rates, which are set by the commissioner. The contracts for leasing the taxicabs and medallions included an optional “Independent Contractor” clause, which states that the lessee is free from the control of the lessor and is not required to remit to the lessor any funds received in connection with the taxicab’s operation. In 2012, licensed taxicab drivers who had signed the Independent Contractor clause filed a complaint against the cab

companies, alleging that they were improperly classified as independent contractors. Should the taxicab drivers be classified as independent contractors? [*Sebago v. Boston Cab Dispatch, Inc.*, 471 Mass. 321 (2015).]

Answer: In Massachusetts, there is an independent contractor statute that regulates whether or not a person is an employee is an independent contractor. The purpose of the law is “to protect workers by classifying them as employees, and thereby grant them the benefits and rights of employment, where the circumstances indicate that they are, in fact, employees.” However, in this case, the Court examined the relationship between the cab drivers and cab owners and found that the owners did not exercise control over the contractors and, therefore, the cab drivers were not employees. It is important to note that determinations of employment status are done case by case, with decisions being determined based on individual circumstances. Signing the “independent contractor” clause is not in and of itself enough to be considered an independent contractor.

7. Twenty-five former student registered nurse anesthetists (“SRNAs”) who attended a master’s degree program at Wolford College, LLC, were required to participate in a clinical curriculum, which, under Florida law, was a prerequisite to obtaining their master’s degrees. The students had to participate in a minimum of 550 clinical cases in a variety of surgical procedures. The patients with whom these students worked paid the hospitals or clinics for these surgical services through their health insurance or out of pocket. The students received none of that money. The students sued to receive unpaid wages and overtime under the Fair Labor Standards Act for their clinical hours. The Eleventh Circuit found it appropriate to “focus on the benefits to the student while still considering whether the manner in which the employer implements the internship program takes unfair advantage of or is otherwise abusive towards the students.” Do you think the student interns were employees entitled to wages? Do you think there are scenarios where interns should *not* be entitled to wages? If the court does find that these students are entitled to wages, who then is liable: the university or the clinics? [*Schumann v. Collier Anesthesia, P.A.*, 803 F.3d 1199, 1209-12 (11th Cir. 2015)]

Answer: The district court had previously ruled on summary judgment that the interns were merely students, *not* employees. The Eleventh Circuit had vacated that decision, remanding with instructions to analyze the employment status issue under an approach similar to the Second Circuit’s recent decision in *Glatt v. Fox Searchlight Pictures, Inc.*, rather than using the Department of Labor’s six-factor trainee/employee test. The DOL’s test, in the Eleventh Circuit’s view, was outdated and ill-suited for twenty-first century educational internships.

Glatt factors. On remand, the court found it was no simple matter to apply the *Glatt* factors because the underlying facts in this case were vigorously disputed. For instance, one *Glatt* factor asks whether an internship provides training similar to that which would be given in an educational environment. The evidence here suggested that much of the program was “a bona fide internship” that primarily benefitted the interns, but also that, at least at times, the defendants placed their business interests first when it came to assigning tasks to the interns, short-changing aspects of the interns’ education. The parties also clashed over the application of other *Glatt* factors. Did the interns’ work complement, rather than displace, the work of paid staff? Was there a legitimate reason to schedule interns for working hours at

times when the internship program was “out of session”? Did the internship’s duration exceed the period in which it provided beneficial learning? These and other issues would have to be resolved at trial.

Ownership of the college as a factor. The interns argued, and the court agreed, that another potentially relevant factor in determining their employment status was that Wolford College is a for-profit institution owned entirely by Collier Anesthesia’s physicians.

Although *Glatt* does not mention factors such as this, its list of factors is expressly nonexclusive. “The focus on making a profit,” the court observed here, provides “a greater incentive to elevate shareholders’ financial interests over students’ educational experience.” If the interns could “draw a connection between the educational deficiencies they allege made them ‘employees’ and either Collier’s ownership of Wolford or Wolford’s for-profit status (or both), they will be permitted to so argue at trial.”

8. Arman was hired to drive an airport shuttle for a rental car company back and forth from the airport to the rental car company’s off-site parking lot. When Arman was hired, he signed a written contract that stated specifically that he was an independent contractor. He was paid every two weeks, based on a rate per mile plus an hourly rate for waiting time. He drove the shuttle at times and to locations directed by the rental car company and was on call twenty-four hours a day. Is Arman an employee or an independent contractor?

Answer: despite the language of Arman’s contract, a court would likely find that he is an employee of the rental car company, rather than an independent contractor. The relevant factors suggesting employee status are the biweekly pay and hourly rate arrangement, Arman’s lack of control over his time and work process, and the presumption that the tools of his service (the airport shuttle) was provided by the rental car agency.

A signed contract that states that the agent is an independent contractor will not be recognized by the court as decisive evidence of that status; instead, the court will examine the specific contract provisions and the factual conditions in the particular case under review.

9. Anthony and Philip Conway founded and operated Rochester Medical Corporation (RMC), a publicly traded medical-device company. C.R. Bard, Inc., (Bard) offered to purchase RMC at a very attractive price. Bard insisted, however, that the Conways had to sign five-year non-compete agreements. The Conways reluctantly agreed to sign the non-compete agreements, and Bard purchased RMC at the agreed-upon price. The Conways were paid tens of millions of dollars for their stock and other interests in RMC. The Conways began experiencing sellers’ remorse, however, over the fact that although they had been required to sign non-compete agreements for the deal to go forward, the per-share price that they received for their stock was the same as the per-share price received by the other stockholders. The Conways filed suit, alleging that the non-compete agreements are unenforceable. Is the non-compete agreement enforceable? Do you think the non-compete was reasonable? Why or why not. [*Conway v. C.R. Bard, Inc.*, 76 F. Supp. 3d 826, 827 (D. Minn. 2015).]

Answer: the Court found that the non-compete agreement was enforceable and dismissed the case on Bard's request. The Conways argued that the agreements were "contrary to public policy under Minnesota law and to the public interest in Minnesota and the United States." The court did not find enough evidence to support this claim, however. Though this case was dismissed, it would be possible for a court to rule that a 5 year non-compete is excessive. A court might modify the duration of the non-compete agreement. Typically, non-competes for six months to a year are found to be reasonable. Also, in making the agreement, the Conways may have argued for additional compensation above the price the other shareholders received, in return for the five-year non-compete—the problem here was that they asked for it after the deal had been made. In general, a company would need to show good reason for a five-year non-compete. The company may also need to show that it would not be harmful to the public good.

10. Freedom Medical, a medical equipment company, sought an injunction to prevent three former executives and sales representatives from working for one of Freedom Medical's competitors, Med One. To maintain a competitive advantage in the healthcare industry, Freedom Medical developed confidential and proprietary pricing information, business plans and customer lists that all three former executives had access to in their former positions. Freedom Medical takes several affirmative steps to safeguard this confidential information. First, Freedom Medical requires all employees to acknowledge and agree to comply with an Acceptable Use Policy that restricts the use of digitally stored confidential information. Second, Freedom Medical requires all employees with access to confidential information to sign restrictive covenants at the inception of their employment. The restrictive covenants prohibit unauthorized use or disclosure of confidential information. Furthermore, the restrictive covenants contain a global non-compete clause that prohibits employees from working for any competitor for a one-year period following the end of employment with Freedom Medical. All three former executives were hired as sales representatives for Med One, and two of the three stayed in the same geographic territory in which they previously worked for Freedom Medical. Freedom Medical has filed an injunction to stop them from working for Med One. Should the court issue the injunction? If so, for how long and should there be any other restrictions? [*Freedom Med. Inc. v. Whitman*, 343 F. Supp. 3d 509 (E.D. Pa. 2018)]

Answer: In *Freedom Med. Inc. v. Whitman*, the United States District Court for the Eastern District of Pennsylvania found that the plaintiff took reasonable measures to keep its price schedules secret by: (i) defining pricing information as confidential; (ii) generally restricting its disclosure; and (iii) utilizing restrictive covenants to prohibit departing employees from taking or using confidential information. They, therefore, issued the injunction.

Most courts hold that a term of more than a year in non-compete clauses is generally unreasonable.



Case Icons:

Opinion Letter from Acting Administrator- US Department of Labor

The opinion letter issued is:

- [FLSA2019-6](#), addressing whether a service provider for a virtual marketplace company is an employee of the company or an independent contractor under the FLSA.

A VMC operates in the “on-demand” or “sharing” economy and is generally an online and/or smartphone-based referral service that connects service providers to end-market consumers to provide a variety of services, such as transportation, cleaning and household services. Uber, DoorDash, Lyft, Etsy, eBay and Rover are all examples of a virtual marketplace. One unnamed VMC sought the DOL’s opinion on service providers and the DOL based their opinion on the facts that company presented.

Under the FLSA, the existence of an employer-employee relationship is determined by the economic reality of the relationship; namely whether the worker is economically dependent on the hiring entity. The DoL concludes that the workers who provide services to consumers through this specific company's virtual platform are independent contractors, not employees of the company. To make this determination, WHD applied its longstanding and unchanged six-factor balancing test, derived from Supreme Court precedent:

- The nature and degree of the potential employer's control;
- The permanency of the worker's relationship with the potential employer;
- The amount of the worker's investment in facilities, equipment, or helpers;
- The amount of skill, initiative, judgment, or foresight required for the worker's services;
- The worker's opportunities for profit or loss; and
- The extent of integration of the worker's services into the potential employer's business.

Case Questions:

1. Say for discussion the company being evaluated in this letter is Uber and whether their drivers are independent contractors or employees. Do you agree with the analysis by the Department of Labor that the drivers would not be employees?

Answer: Students’ answers will vary. However, students should consider the primary components of the balancing test. Does Uber have control over their drivers? Does it help or hurt that Uber requires drivers to provide their own vehicle/insurance, etc? Would these drivers be able to work in this type of business without the Uber platform providing customers, payment processing and directions?

2. Why is important for the Department of Labor to publish an opinion on this topic? What impact could it have on Virtual Marketplace Companies like Uber, Postmates, GrubHub?

Answer: This type of opinion from the Department of Labor helps companies make decisions around creating their virtual marketplace companies. If they create an app that relies heavily on independent contractors, to ensure they stay independent contractors in the eye of the court for purposes of liability, taxes, etc, the company can make sure they meet each of the criteria the DoL spelled out. The DoL emphasized that it is important that the VMC not prohibit the IC from working for other companies and that they ensure all vehicles are provided by the driver, etc. These would then become standards the VMCs would want to follow in their hiring process. Additionally, these letters help the Courts have some guidance when interpreting the law in lawsuits that consider questions around whether these individuals working for VMCs are ICs or employees. Investors in VMCs can also have more comfort around liability risk with this type of guidance.

3. What variables would need to change in the relationship between the client and the company for the DOL to deem the clients as employees?

Answer: There are a variety of answers to this questions, but students should focus their discussion around what might impact each of the variables in the balancing test. For example, if the VMC were to prohibit their client from working for competing VMCs that might change the nature of the employment. Further, does the client undergo mandatory training or do they contribute heavily to the maintenance of the platform for the VMC?

Osborne Assocs. v. Cangemi, 2017 WL 5443146 (M.D. Fla. 2017)

Issue: Did two former employees of a professional salon and spa service company for senior living facilities violate their non-compete clauses when they began their own business in the same industry?

Facts:

For approximately twenty-five years, Osborne Associates, Inc. d/b/a Generations Salon Services (“Generations”) has provided professional salon and spa services to residents of senior living facilities. However, while the residents were the ultimate service recipients, Generations did not transact business with them directly, but instead with the senior living facilities where they resided. In this niche market, business relationships between salons and senior living facilities are typically continuing in nature and subject to exclusivity contracts that impede the facilities’ use of competing businesses.

In March 2016, Generations hired Sheryl Cangemi as its Director of Business Development (based in Florida), and Julie Calianno as the Regional Operations Manager for its Pennsylvania territory. Cangemi and Calianno both signed restrictive covenant agreements that prohibited them from “working in a competitive activity for a period of one year following the termination of employment; soliciting any client, customer, officer, staff, or employee of Generations Salon

for [a competing purpose]; and using or disclosing Generations Salon's confidential and proprietary information." Given that Calianno was employed in Pennsylvania rather than Florida, her agreement called for enforcement under Pennsylvania law.

Less than one year after their hire dates, Cangemi and Calianno resigned from Generations and joined forces to operate a competing business. Generations filed suit and sought a preliminary injunction against Cangemi and Calianno, claiming they violated their agreements by competing with the company, soliciting the senior living facilities that it counted as customers, and using Generations' confidential customer information to convert business to their new company.

In opposition, Cangemi and Calianno argued that their restrictive covenant agreements were not supported by any protectable interests.

Holding:

The court held that under both Florida and Pennsylvania law, Generations had protectable interests in its customer relationships, as well as customer lists and other specialized confidential information it developed in furtherance of the relationships. Cangemi and Calianno violated their non-compete clauses and are enjoined from furthering their business.

Reasoning:

Importantly, had Generations transacted business directly with the *residents*, rather than their senior living facilities, it would have been much more difficult to establish protectable customer relationships. As the court explained, customer relationships cannot be fleeting, and are more likely to be protected where: (a) active, ongoing business is being conducted; (b) the business is contracted to be the exclusive service provider for the customer; (c) the customer cannot be easily identified by competing businesses; and/or (d) there is an expectation of continued business. Those elements are not typically found where services are provided to members of the general public.

In Generations' case, however, it entered into exclusive contracts with senior living facilities to provide services for *all* residents of those facilities. Further, Generations' business relationships with the senior living facilities were active and ongoing. As such, the court held that Generations successfully established a protectable interest in its customer relationships, which, under Florida and Pennsylvania law, supported the enforcement of non-compete and non-solicitation covenants.

The court also held that the restrictive covenant agreements were necessary to protect Generations' confidential business information. Under both Florida and Pennsylvania law, business information is not protectable if it is commonly known and accessible to other businesses in the industry. On the other hand, "business information which is not otherwise readily available to the public, or has been acquired or compiled through the industry of a party, can be deemed a protected legitimate business interest." Here, Generations provided Cangemi and Calianno with access to not just the names of its senior living facility customers but also high-level customer contact information, customer-specific pricing and sales information, and marketing strategies – information the court found to have been uniquely developed and not readily available to the public. Generations also took reasonable steps to protect the confidentiality of such information through non-disclosure agreements and restrictions on

employee access. As such, the court concluded that Generations had a protectable interest in its customer lists and related confidential business information.

Case Questions:

1. What alternative fact pattern might change the court's decision on whether Cangemi and Calianno breached their non-competes?

Answer: If Generations did business with the residents of the senior living homes individually rather than contracting with the residence itself. The court deemed it would be more difficult to establish an ongoing, exclusive relationship with just residents. Further, if Cangemi and Calianno had not had access to high level leadership info for the various senior living facilities and just had what is readily available on a general internet search.

2. If Generation Salon didn't have their proprietary Stangleware database, would this case come out differently?

Answer: Perhaps. There is still the issue of the exclusive relationships with senior living facilities that present a substantial business interest to justify non compete clauses in the court's eyes. However, without the proprietary information, it might be less convincing to the court.

3. Is it fair to restrict Cangemi and Calianno from using their knowledge to begin their own business in this industry?

Answer: Student answers will vary, but they will likely touch on issues related to how an individual is ever expected to start a business after working for another in the same industry. Further, they should discuss what parameters would make it fair for both parties. Is it just time? If Cangemi and Calianno had waited a year after quitting and then began their business, would that have changed things? Business' have a legitimate need to keep competitive relationships with clients and strategic information they have spent money and time to develop, so they should also be able to protect it.