REGULATION OF THE WORK PERFORMANCE RELATIONSHIP: INDEPENDENT CONTRACTORS, LABOR SUBCONTRACTORS, AND JOINT CONTROL OVER AN EMPLOYMENT LIKE RELATIONSHIP

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SUMMARY: I. Introduction. II. Who is covered and who is excluded from the protective scope of labor law, and the legal consequences for those excluded as independent contractors or owners. III. Benefits and burdens of the "employment relationship" characterization compared to a contract for services. IV. Speculations about solutions to the work relationship problem.

I. INTRODUCTION

American newspapers are currently full of reporting about the so-called "jobless recovery" of the U.S. economy. Although the economy is expanding at a fairly brisk pace, employment in the formal economy shows little sign of improvement. One explanation increasingly being offered by economists is that more and more people are earning a living, and performing work, as "independent contractors", or "consultants", that is, outside the scope of a formal employment relationship. This is not a claim that there has been a large increase in work performed in the informal economy, although there may also have been an increase in people "working off the books", particularly among undocumented workers. Rather, what these economists suggest is that a growing percentage of work is being performed by larger businesses subcontracting the performance of specific functions to individuals who are in business for themselves. The income these self-employed independent contractors earn is reported for tax purposes both by the employing business and by the recipient independent contractor-worker

This explanation is, at present, based on little more than speculation. Hard data have yet to be collected containing sufficiently precise information to confirm or deny the hypothesis. I would speculate on the contrary, however, that existing legal regulation of the performance of work by independent contractors as opposed to employees, renders a shift from employment to lawful independent contract work an unlikely explanation for such a large scale discrepancy between increasing GDP and decreasing formal positions of employment. There are several other factors which suggest themselves as holding at least equal explanatory power.

An increase in unlawful recharacterization of the work performance relationship from one of employment to one of independent contract, is almost certainly an important factor. Outright illegal or informal employment, unreported and untaxed, is probably also on the increase, particularly among undocumented workers.

On the other hand, U.S. companies are also reducing labor costs through lawful means, overt or covert. U.S. Law permits businesses tremendous flexibility in the organization of the company, and in the allocation and compensation of its workers. Many U.S. businesses are achieving productivity gains and decreased labor input costs through technological change and through improved organization of work and utilization of existing technology, that is, they are able to produce more and better goods and services using fewer people. This relatively benign method of improving the bottom line profits for a business often relies on work force reduction through attrition, and normally preserves or even increases employee remuneration.

Some businesses, especially those in financial distress, openly impose outright wage and benefit reductions on their workforce. Wages are, however, notoriously sticky on the downside; reductions in nominal pay rates cause serious employee morale problems. Many more companies therefore adopt less obvious means to cut labor costs. In the 1970s and 1980s, adoption of a “two tier” wage system was a common solution, especially in firms with collective bargaining relationships. The existing workforce maintained or modestly increased its pay scale, while later hires entered the workforce under a parallel, much lower pay scale. Firms and unions learned, however, that in the longer term, this approach is unsustainable, because a tipping point will be reached. Once too high a proportion of the workforce is on the lower pay scale, the two are likely to be merged, at the expense of preservation of the wage standard of the more senior segment of the workforce.

A more current trend is for businesses to reduce their fringe benefit contributions for health care and pension coverage, shifting higher proportions of these costs to employees, causing a decrease in the employees', net income, and sometimes reductions in the level of benefits as well. Whether this merely holds the employer's total labor costs constant, or actually decreases them, of course, depends on the rapidity with which the fringe benefit costs are increasing, and the degree to which the employer shifts them to the workers. Although less obvious to the employees, this type of indirect net compensation reduction also risks antagonizing employees, and in unionized businesses, risks provoking labor disputes, such as the strike commenced in late 2003 at major West Coast grocery store chains.

Labor cost decreases are increasing accomplished through a variety of less self-evident means. Corporate restructuring to spin off non-core portions of the business and then subcontact with the new entities for less costly provision of component parts or of services, as well as corporate substitution of indirectly hired labor, interposing labor intermediaries as the nominal employer of workers in less central function of the business, is a growing trend. In part, these maneuvers allow larger businesses to adopt a two tier wage structure, differentiating between workers in core functions and those in the periphery, while interposing another business entity, the new subcontractor employer of the labor, as a rational for the often dramatically lower wages and fringe benefits of the workers now performing those non-core functions, avoiding some of the worker backlash which commonly accompanies more open compensation reduction measures.

This list would be incomplete without mentioning the rapidly growing volume of outsourcing overseas of labor intensive, low wage operations. When a small number of highly paid, managerial and professional positions remain in the U.S. while the low value added manufacturing is shifted from country to country in search of the lowest labor costs, productivity measures for U.S. companies show strong increases, and labor costs relative to unit produced or sold in globally integrated processes, decline.

These factors would appear to me to account for the bulk of the increase in GDP, and lack of increase in paid employment within the U.S., far more so than the movement by some businesses to transform their relationships with their workers from one of employment to one of individual independent contract.

The reason for my skepticism about the actuality of a wholesale shift to performance of work by legitimate independent contractors is simple: given the relatively low level of obligation imposed upon U.S. employers in favor of their employees, the great flexibility and control conferred upon employers under U.S. Law, and the substantial set of favorable rules conferring benefits upon employers as against their employees, U.S. employers do not stand to gain nearly as much as their foreign counterparts by restructuring their work performance arrangements to legally qualify as independent contractual relations rather than those of employer and employee. Moreover, improper characterization of the employment relationship exposes the labor-using employer to substantial liability under both tax and labor standards laws.

To legally transform the relationship into one of independent contract, the parties must do more than simply agree to opt out of coverage of the labor laws; the nature of the work and its performance must be structured so that the employer's control over the manner and means of its performance is less complete than in a normal employment relationship. Where the business employing the labor or services is able to loosen the bonds of control sufficiently to have the work performed outside their business organization, on the other hand, the firm often prefers not to directly contract with the individuals who will perform the services. It may be more advantageous for the business either to contract with a smaller firm which specializes in providing those services, or with a temporary labor supply agency. In such cases, the individuals actually performing the work remain legally employees, and do not become independent contractors. However, they are now legally employees of the service contractor or of the temporary labor supply agency. In some cases, they will be deemed legally also to be employees of the business for whom the work is performed, who will be labeled a "joint employer" with the service contractor or labor supply agency. In short, while it is not clear in all cases exactly who is the employer of these workers, it is clear that they are legally "employees," rather than independent contractors.

There are many legal advantages and modest drawbacks to the employer of the labor in characterizing the relationship as one of employment. On the other hand, if the work is structured as an independent contractual arrangement, all of the normal rules of contract law pertaining to contracts between businesses will apply to the relationship. Instead of the terms of the relationship being construed based on the legally-defined status contract of employment, the terms will be construed from a neutral contractual intent vantage point. Unlike the law in many other developed countries, however, one can hardly say that the law of the employment relationship in the United States primarily protects employees' interests. Many aspects, particularly those regarding business control over proprietary information, company possession of intellectual property interests developed by workers, and the ability of the employee to perform work for the company's competitors during or after completion of the worker's employment with the company are tilted for the most part in favor of the employer. The trade-offs between structuring the relationship as one of employment or as one legitimately of independent contract, in other words, are significant. Particularly in high tech or knowledge-based fields, these considerations may militate in favor of businesses retaining the employment relationship, quite apart from the more usual considerations of long-term retention of core employees with key employer-specific knowledge.

In terms of issues arising under current law, it is true that it is often difficult to discern the legal boundary line between employer-employee status, on the one hand, and independent contract on the other, and that there is a large volume of litigation on this subject. That volume may be deceptive however, since employers who fail to pay their employees in compliance with the law often resort to defending their conduct by claiming the relationship was one of independent contract rather than employment, even when the defense plainly lacks merit. Two other legal issues are arising more and more frequently, whose resolution may be of equal or greater importance in stemming the tide of corporate restructuring of work relationships so as to escape from the regulatory strictures of labor legislation. The first is whether a worker is an owner, an employee, or both at once, when the worker has a high level position in certain types of small business organization. The second issue arises when workers who are nominally employees of a labor intermediary or a subcontractor, perform work on behalf of another business. The question there is whether, and under what circumstances, there is also a legal employment relationship with the company for whom the work is actually being performed, and for which legal purposes. This is often labeled a "joint employer" relationship. These very important legal issues, however, provide no explanation for the gap between increasing GDP and stable or declining numbers of jobs in the United States.

Correctly diagnosing what is occurring in the U.S. workplace is important for reasons going beyond electoral politics and macro-economic policy analysis. Several commentators have urged that the U.S. adopt some form of "dependent contractor" legislation, creating a new category of workers mid-way between employees and independent contractors, with some of the rights and protections of employees, rather than being subject to the usual rules governing commercial contractual relationships. Others have urged clarifying, and broadening the definitions of "employee" as opposed to "independent contractor" for purposes of labor law coverage.[1]

Although I am sympathetic to these projects, the latter more so than the former, I am doubtful that either alone will cure the problem. On the one hand, too much outright illegal activity is occurring under existing law, indicating that a change in law enforcement strategies and resources, and perhaps in remedies to induce greater private enforcement activity, is essential. On the other hand, the problem of corporate disaggregation, so called boundary-less employers, insourcing as well as outsourcing, labor middlepersons and supply agencies, and layered corporate workplace relationships is growing, as is the evaporation of employment rights and obligations as to the growing category of non-self-employed workers with direct capital investments in their own small businesses. A solution must take account of these new escape hatches, or competitive pressures may induce employers to shift the form of their arrangements without substantive change. Any solution is likely to be one tailored to the distinctive American labor law context, as well as responsive to unusual features of U.S. Labor markets.

The remainder of this paper will first sketch out the contours, coverage, and exemptions from U.S. collective and individual labor law, and in contradistinction, those limited provisions pertaining to individual independent contractors performing work directly for another business. Next, it will outline legal advantages to a business entity employing labor to doing so through the normal employment relationship rather than by hiring an independent contractor, either in the form of a subcontractor or an individual worker. Finally, it will suggest some partial solutions to the developing

[1] See, e. g., Marc Linder, "Employed or Self-Employed?", Dependent and Independent Contractors in Recent U. S. Labor Law. An Ambiguous Dichotomy Rooted in simulated Statutory Purposelessness, 21 Comp. Lab. L. & Pol'Y J. 187 (1999).

problem of workers performing labor for businesses while falling outside the framework of labor legislation.

II. WHO IS COVERED AND WHO IS EXCLUDED FROM THE PROTECTIVE SCOPE OF LABOR LAW, AND THE LEGAL CONSEQUENCES FOR THOSE EXCLUDED AS INDEPENDENT CONTRACTORS OR OWNERS

1. The overlapping and diverse bodies of labor law in the U.S.

Both collective and individual labor law[2] in the United States are highly fragmented. Separate federal labor laws, the National Labor Relations Act (NLRA),[3] the Railway Labor Act (RLA),[4] and the Labor Management Relations Act (LMRA),[5] regulate private sector union organizing, collective bargaining, and labor relations.[6] The Norris-LaGuardia Act[7] precludes federal court jurisdiction to intervene and enjoin strikes and picketing during private sector labor disputes. Public sector labor law, both individual and collective, is regulated at the federal level for federal employment; at the state level for state and local government employment.[8]

2 This paper will use the prevalent comparative law terminology "labor law" to refer to all aspects of the law governing the employer-employee relationship. It will use the widely recognized terminology "collective labor law" to refer to what in the U.S. is now primarily called "labor law" or labor-management relations law. It will use the widely recognized phrase "individual labor law" to refer to what in the U.S. is now mainly referred to as "employment law".

3 29 U. S. C., pp. 151-169.

4 45 ibidem, pp. 151-163, 181-188.

5 29 ibidem, pp. 181-189.

6 On U.S. collective labor law, see generally, e. g., Marley S. Weiss, "The Right to Strike in Essential Public Services in the U.S.", in Kurczyn Villalobos, Patricia (ed.9, Relaciones laborales en el siglo XXI, 2000, pp. 95-196.

7 29 U. S. C., 101-115.

8 This paper will for the most part omit discussion of the public sector. Public sector collective bargaining legislation is separate from, and in some details, differs importantly from the laws applicable to the private sector. More importantly, until now, most federal, state, and local government employees have been protected by civil service legislation, which provides significant protection against arbitrary discharge without cause, as well as some regulation of employee selection for promotions, pay rates, pay increases, and fringe benefits. In recent years, however, the impetus for government subcontracting of operations under the privatization rubric, as well as a trend toward reducing or eliminating civil service coverage for government employees has made the situation more com-

Individual employment law is addressed in a host of separate federal laws. The names, to some extent, identify the aspect of employment being regulated: the Occupational Safety and Health Act (OSHA),[9] the Employee Polygraph Protection Act of 1988 (EPPA);[10] the Employee Retirement Income Security Act (ERISA);[11] the Worker Adjustment and Retraining Notification Act (WARN);[12] the Fair Labor Standards Act (FLSA);[13] the Family and Medical Leave Act of 1993 (FMLA),[14] Three modern federal equal employment opportunity laws, Title VII of the Civil Rights Act of 1964 (Title VII),[15] the Age Discrimination in Employment Act of 1967 (ADEA)[16] and the Americans with Disabilities Act of 1990 (ADA),[17] prohibit discrimination in hiring, firing, and all terms and conditions and privileges of employment, on the basis of race, sex, color, religion, national origin, age, and disability. The NLRA prohibits discrimination based on union activity.[18] These laws, as well as each of the other federal statutes mentioned above, contain separate provisions which prohibit adverse employment actions taken in retaliation against a worker who exercises rights under these laws or cooperates with the relevant federal enforcement agency in enforcement-related proceedings.[19] Because U. S. labor law in most areas lacks anything approximating substantive

parable in many respects to the private sector. Nevertheless, many important distinctions remain.

9 29 U. S. C., §§651-678.

10 Ibidem, §§2001-2009.

11 Ibidem, §§1001-1461, 26 ibidem, §§401-418E.

12 1bidem, §§2101-2109.

13 Ibidem, §§201-219.

14 Ibidem, §§2601-2659.

15 Ibidem, §2000e to §2000e-17.

16 29 ibidem, §§621-634.

17 42 ibidem, §§12111-12118.

18 Section 8 (a) (3) of the NLRA, 29 ibidem, 158 (a) (3).

19 See, e. g., Section 704 (a) of Title VII, 42 ibidem, 2000e-3 (a) (prohibiting retaliation against those who oppose discriminatory employment practices forbidden under Title, or who invoke or cooperate with enforcement procedures); Section 510 of ERISA, 29 ibidem, §1140 (prohibiting employers from taking adverse employment action in retaliation for exercise of employee rights under ERISA or under ERlSA-covered benefit plans or to prevent employee from utilizing ERISA plan benefit entitlements); Section 8 (a) (4) of the NLRA, 29 ibidem, §158 (a) (4) (prohibiting retaliation against employees who files charges with the National Labor Relations Board or cooperate in NLRB enforcement activities); Section 15 (a) (3) of the FLSA, ibidem, §215 (a) (3) (prohibiting retaliation against employee for exercising rights under FLSA or participating in enforcement efforts).

minimum standards, such as standards regarding occupational qualifications for many jobs, criteria for hiring, for promotion, or for termination of employment, these restrictions on the reasons for which an employer may make employment decisions play an extremely important role in constraining employer discretion.

State law is displaced from addressing private sector collective labor relations, as well as from regulating employment-linked fringe benefit areas falling under the federal statute, ERISA. All other areas of the employment relationship, however, are open to state regulation overlapping or in addition to that provided under federal law. State law cannot conflict with federal law. In practice, this is roughly equivalent to the approach common in continental Europe, permitting derogation from federal law in favor of but not against the interests of the worker. The states may provide higher labor standards, or additional protections for employees, and they may protect workers excluded from the protections of particular federal laws, but they cannot exempt employers or workers from federal laws or decrease the workers' rights or benefits under federal law. To determine the legal rights and duties of employers and employees, or of parties to an independent contract work performance relationship, one must examine the conjunction of federal law, plus the law applicable in the relevant state, normally the state in which the work is performed.

Each of the fifty states as well as the District of Columbia has enacted its own, unique set of laws. A typical state has a separate statute providing for workers' compensation for occupational injury and illness, a law establishing an unemployment insurance system, an occupational safety and health law, one or more state laws prohibiting employment discrimination, covering the federally prohibited grounds of race, sex, religion, color, national origin, age, and disability, and sometimes adding other prohibited grounds such as sexual orientation, marital status, height or weight, family responsibilities, or genetic information.[20] State anti-discrimination laws, like the federal laws, usually include anti-retaliation provisions. In addition, many other state labor statutes include anti-retaliation provisions. For example,

[20] See, e. g., Md. Ann. Code, 16 (prohibiting employment discrimination on the basis of race, color, religion, sex, age, national origin, marital status, sexual orientation, genetic information, or disability); Mich. Comp. L. Ann 37.2202 (religion, race, color, national origin, age, sex, height, weight, or marital status); NY CLS Exec 291 (2003) (age, race, creed, color, national origin, sexual orientation, military status, sex, disability, genetic predisposition or carrier status, or marital status).

state law in many states prohibits employees from being discharged because they invoked administrative or judicial remedies when their employer failed to pay them on time, or paid less than required either contractually or by virtue of state law.[21] When grounds for adverse employment action under state law are added to those prohibited under federal law, a substantial network of restrictions on employer discretion is the result, although negative regulation forbidding specified grounds is not the equivalent of direct affirmative regulation of permissible reasons.

The states regulate wages fairly heavily. Nearly all states have their own minimum wage and overtime laws, which in several states set a higher minimum than that established by the federal FLSA.[22] State laws also regulate other aspects of wage payment, typically requiring that wages be paid within so many days after they have been earned, on a periodic basis, in cash or check, or sometimes by direct bank account deposit.[23] These laws often go farther than the federal FLSA[24] as well as state minimum wage legislation in restricting legally permissible deductions from employees' wages, and requiring written consent of the worker for certain optional types of deductions, such as those for job-related benefits to which the employee contributes and charitable contributions.[25] Laws adopted in several states require employers at the time of hire to provide new employees with specific information regarding job classification, wages, wage payment schedule, and other factors.[26]

To a lesser extent, states regulate working time and leaves of absence. Many states also set minimum standards for family and medical leave, sometimes mandating longer leaves or covering more employees than the federal FMLA. Some states also regulate working hours. A handful have retained vestiges of historic "blue laws," prohibiting Sunday work or making it optional with the employee. A few set maximum working hours per

21 See, e. g., Md. Ann. Code, Lab. & Empl., 3-428 (Maryland state minimum wage law anti-retaliation provision).

22 See ABA Section of Labor and Employment law, the Fair Labor Standards Act, App. J.2., at 282 (Supp. Spring 2000) (listing state wage and hour laws).

23 See, e. g., Md. Ann. Code, Lab. & Empl., 3-502.

24 See Section 3 (m) of the FLSA, 29 U. S. C. §213 (m) (together with Department of Labor regulations issued to implement this provision, limiting permissible payroll deductions for employer-provided meals, housing, general merchandises, utilities, transportation, educational tuition costs, uniforms and cleaning of uniforms).

25 See, e. g., Md. Ann. Code, Lab. & Empl., 3-503.

26 See, e. g., ibidem, 3-504.

day. Many specify mandatory rest or lunch breaks after a given number of hours of work.

Apart from the many statutes in effect in each state, every state has its common law jurisprudence governing contract and tort law. Although common law doctrine is similar across all the states, it varies in detail among them, and these details are often significant for the employment relationship. The body of generally applicable state tort and contract law is almost totally applicable to the relationship between independently contracting parties, including contracts for the performance of services; in every state. On the other hand, however, the historic U.S. common law doctrine of employment-at-will, to be discussed shortly, has led the courts to modify the normal tort and contract jurisprudence when cases arise in the context of the employment relationship.

2. Coverage and exclusions from federal and state labor laws

This litany of laws highlights the extensive, fragmented, and among the states diverse nature of law pertaining to the employment relationship is significant for present purposes in several respects. It illustrates the substantial extent of regulation of the employment relationship and protection of workers contained in U.S. law. Contrary to the externally prevalent vision of the U.S. as a laissez faire labor market, the law does indeed regulate many important aspects of the employment relationship. On the other hand, there are important holes in these protections, notably the lack of provision for job security against arbitrary discharge; the lack of severance pay or other income security against economically-based job loss, apart from unemployment insurance; and in most states, the dearth of regulation of working time. Despite these lacks, however, a worker in the informal sector or one who lawfully is categorized as a non-employee excluded from legal protections, does in fact lose significant protections.

In addition, the laundry list of statutes highlights the extremely fragmented nature of U.S. law governing the workplace, each of which contains its own separate provisions regarding coverage. With a few exceptions, most of these laws define coverage in terms of who is an “employer” regulated by the statute, and who is an “employee” as to whom those “employers” are regulated. For an employment relationship to be covered by the substantive law, the employer must meet the definition of “employer” under that specific law, the worker must be an "employee" under that same law, and the worker must be employed by "that employer". There is no uniform definition of these terms, although there are important common themes which permit me to fit the analysis into a few categories.

The federal nature of the U. S. legal system, and the overlapping competence of the state and federal governments in the field of labor law, as well as the common law approach and the absence of any tradition of comprehensive, cohesive codification, limit the possibility of enacting any truly uniform solution to the problem, although prominent commentators have urged that one be adopted.[27] Indeed, although there have been efforts in fields such as commercial law to develop a uniform or model statute which each state would separately enact, the end result has been convergence but not complete uniformity. Each state retains the authority to enact its own variations, and some inevitably do. Moreover, each state's court system, retains the exclusive interpretative competence over the version of the statute enacted in that state's legislation, leading to variations among the states in judicial interpretation of identical statutory language.

A. "Employer" status

Federal law under the U.S. Constitution is limited to regulating businesses engaged in interstate commerce. Although that covers a very high proportion of the economy, the smallest, purely local businesses are exempted from federal statutes. Beyond that, however, many federal labor statutes are designed to minimize the regulatory burden on small business, of necessity at the expense of eliminating protection for the workers of those businesses. Federal equal employment opportunity laws set a coverage threshold for employer size based on number of employees employed; fifteen or more employees for purposes of Title VII and the ADA; twenty in the case of the age discrimination statute. The family and medical leave law only applies to businesses with fifty or more employees.[28] In addition,

[27] E. g., Report of the Commission on the Future of Worker Management Relations (1994) (the "Dunlop Commission" Report) recommended uniform acceptance of the FLSA "economic realities" test.

[28] 42 U. S. C. §12111 (5) (A) (ADA definition of "employer" as one who has employed "15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year"); ibidem 2000e (same definition under title VII); 29 ibidem, §2602 (FMLA definition imposing 50 employee threshold).

some statutes are limited to certain industries, or exclude particular industries. Agriculture is excluded from the NLRA coverage of most private industry; airline and railroad transport is excluded from the NLRA because it is placed under its own separate statute, the RLA. Domestic household employment is excluded from most federal labor laws. The NLRA contains special provisions pertaining only to the construction industry and to the garment industry. The FLSA excludes some agricultural work from certain provisions, but separate federal legislation covering agricultural labor fills some of these gaps.

State laws, on the other hand, usually set lower thresholds for employer coverage under equal employment laws and family and medical leave laws, and typically cover all employers operating in the state for purposes of state minimum wage and overtime laws and wage payment laws. In a few states, state statutes fill the federal collective labor law void and provide for union organizing and collective bargaining of agricultural labor.

In summary, the workers eligible to receive the maximum protection from these laws are those working in the “primary sector” of the economy, i. e., employees of large and medium size, non-agriculture, private sector businesses. The smaller and more local the employer, the fewer laws will be applicable regulating the employment relationship. This means, of course, that the most marginal workers, especially those employed by the smallest and least economically secure employers, have the lowest level of legal protection. Still, even the smallest businesses are subject to state wage and hour, wage payment, workers’ compensation, and occupational safety and health legislation in most states. The workers, however, are covered only if they meet the legal definition of “employee” under the relevant law.

B. “Employee” and non-employee status

Each separate statute contains its own definition of “employee,” or sometimes, wholly lacks a definition, which is then supplied by the courts through judicial interpretation. Some statutes, particularly collective bargaining statutes, exclude higher ranking employees such as supervisors and managers, from “employee” status.[29] The FLSA includes most employees for purposes of the minimum wage, but excludes executive, ad-

[29] Section 2 (3) of the NLRA, 29 ibidem. 152 (3).

ministrative, and professional employees from the overtime provisions of the law;[30] regulatory interpretation which will broaden these exclusions at the higher salary levels has recently been adopted by the U.S. government. It is under challenge in the courts, as violating the statute itself, and also under attack in the halls of Congress, where continuing efforts have been mounted to overturn the amended regulation.

Most statutes, on the other hand, purport to cover all "employees" employed by a covered "employer," although some exempt part-time workers, casual laborers, and other forms of atypical work that nevertheless is clearly "employment."Nearly always, however, either the statute or the interpretative jurisprudence differentiates between two categories into which will fall those performing work for a company: employees, in an employment relationship with the business, on the one hand, and independent contractors, on the other.

Although there are differences in detail, and in judicial interpretation, there are two basic approaches taken in the statutes and judicial decisions. One is the common law approach, under which employee status depends primarily on the nature and degree of the putative employer's control over the manner and means by which the putative employee performs the work. The second is the more expansive "economic realities" test, which is designed to encompass subordinated workers dependent for their livelihood upon the putative employer.

The common law test originated in the law regarding respondeat superior, master-servant common law jurisprudence developed to delineate the circumstances under which tort liability for the negligence of a servant or other worker could be imputed to the master. The master, and later the employer, was traditionally held liable for harms negligently caused to third parties by servants or employees, but not by acts of independent contractors. The rationale for the distinction largely turned on the unfairness of imposing liability on the hirer of the performance of work when she or he had no control over how it was to be performed.

The use of the common law test in the very different policy context of binding applicability of labor legislation has engendered substantial criticism.[31] Nevertheless, at least in part because this body of law is so thoroughly

[30] Ibidem, 213.
[31] See, e. g., Linder, note l; Secretary of Labor v. Lauritzen, 835 F. 2d 1529 (7th Cir. 1987) (Easterbrook, J., concurring).

analyzed in the large body of state judicial personal injury negligence law decisions, courts have routinely interpreted labor laws to incorporate this definition either when the statute lacks any "employee" coverage definition, or when it contains a typical, circular definition, such as "an individual employed by an employer".[32] The Internal Revenue Service describes itself as using the common law definition to determine whether the employer of labor is liable to pay the employer's share of social security taxes, and to withhold and remit the employee's share of social security taxes as well as the employee's income taxes, but in fact applies a 21 factor test.

It should be noted that despite the seeming similarity of terminology, there are variations among the states in how they interpret the common law boundary between employment and independent contract relationships in tort, and these variations then carry over to state court interpretations of state statutes deemed to incorporate the common law definition. The Internal Revenue Service regulations incorporate a 21 factor test, a far more specific listing than that usually employed by the courts, either in common law cases or in interpreting state or federal employment laws. The federal courts have tended to follow the most restrictive, traditional definition of the common law test when determing federal labor law statutory coverage, even while the trend in the states has been toward liberalization.

The Supreme Court several years ago elaborated its own version of the factors to be considered as including: "the skill required, the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party' s discretion over when and how long to work; the method of payment; the hired party's role in hiring an paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits and the tax treatment of the hired party". Although no one factor is dispositive, in practice the degree of employer control over the manner and means of performance of the work is critical.[33]

[32] See, e. g., 29 U. S. C. §12111 (4) (using this definition of "employee" under the Americans with Disabilities Act); ibidem §652 (6) (same definition under the Occupational Safety and Health Act); ibidem, §630 (f) (same definition in the Age Discrimination in Employment Act); ibidem, §1002 (6) (same definition under Employment Retirement Income Security Act); 42 ibidem, §2000e (f) (same definition under title VII).

[33] National Mut. Ins. Co. v. Darden, 503 U.S. §§318, 323-24 (1992).

However, the U.S. Supreme Court itself, in interpreting provisions containing this language in different statutes, has not always concluded that a straightforward application of the common law test, however formulated, is appropriate. In the context of those with dual status as equity shareholders and workers, the Court in its recent decision in Clackamas Gastroenterology, 4ssociates, P. C. v. Wells,[34] refused to simply follow its own analysis of this same language developed when differentiating between the firm's internal labor force of employees and the external labor force of independent contractors[35] The Court did, however, embrace the regulatory agency's six factor test, largely adapted from the common law master-servant formulation, which runs as follows:

1) "Whether the organization can hire or fire the individual or set the rules and regulations of the individual's work".
2) "Whether and if so, to what extent the organization supervises the individual's work".
3) "Whether the individual reports to someone higher in the organization".
4) "Whether and, if so, to what extent the individual is able to influence the organization".
5) "Whether the parties intended that the individual be an employee, as expressed in written agreements or contracts".
6) "Whether the individual shares in the profits, losses, and liabilities of the organization".[36]

It is important to note the duality of impact of the boundary line between employee and independent contractor or excluded owner status. On the one hand, it establishes which workers will be counted, in determining whether the employing entity is large enough to be covered by the statute as an employer. On the other hand, it determines whether the individual will receive the protections afforded by the statute. In the context of work-

[34] 123 S. Ct. 1673 (2003).
[35] Compare ibidem (deviating from common law test in construing ADA "employee" definition when determining whether shareholder-worker in small incorporated professional partnership should be deemed to be an "employee" under ADA) with National Mut. Ins. Co. v. Darden, 503 U. S. at 323 (1992) (construing identical ERISA language to incorporate common law "right of control" approach).
[36] 123 S. Ct. at 1680, quoting EEOC Compliance Manual 605.009.

ers who also own a stake in the business, the Court is less willing to count them as employees, unless they are more clearly subordinated to the employing entity's control than would be the case as to a worker lacking a significant share of ownership in the business. To reach this result, however, the Court has had to violate its own maxims about always the same statutory language in the same way.

The majority of the Supreme Court found the evidence inconclusive as to whether the doctors were employees, reasoning fact that "the four shareholders control the operation of the clinic, share in its profits and are personally liable for malpractice by the clinic suggests they are non-employees". On the other hand, in the Court's view, the fact that these doctors received salaries, had to comply with standards set by the clinic, and that they reported to a personnel manager, cut in the opposite direction.[37] The case was therefore sent back to the lower courts for further resolution. The two dissenting justices, on the other hand, found it significant that these doctors had incorporated their partnership for the very purpose of qualifying as employees to gain tax advantaged status for their fringe benefit programs under ERISA. They would have adopted a slightly broader version of the common law master-servant test, turning on whether the worker was "an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right to control by the master",[38] and would have held on the merits that the doctors were statutory "employees," hence the firm was a legally covered "employer".[39]

The dissenters criticized the formula adopted by the majority, based on whether the shareholders act independently and participate in managing the organization rather than being subject to the organization's control, as permitting "a firm's coverage by the ADA ...[to] sometimes turn on variations in ownership structure unrelated to the magnitude of the company's business or its capacity for complying with federal prescriptions".[40]

A deeper criticism, however, not voiced by the dissent, is that this "either or formulation" rests on a false assumption. Often; shareholder/employees will embody elements of both a management role and being sub-

37 Ibidem at 1681 & n. 1l.
38 Restatement (second) of Agency 2 (2), quoted in Clackamas, 123 S. Ct. at 1681.
39 Clackamas, 123 S. Ct. at 1681, 1682 (Ginsburg and Breyer, J. J., dissenting).
40 Ibidem at 1682 (Ginsburg & Breyer, J. J., dissenting).

ject to control by the firm in the performance of their work. Nor does it respond well to the question of why a partnership, incorporated or otherwise, should exclude its top level personnel from categorization as "employees" when they are clearly common law agents of the firm, unless they are so highly placed and the firm is so structured, that like the sole proprietor of an unincorporated business, they need respond to no one about their activities on behalf of the firm.

The majority opinion in Clackamas suggests that its reasoning may apply to partners in conventional, unincorporated partnerships as well as to those in professional corporations, and that the result should not depend on the firm's choice of whether to incorporate.[41] The boundary line between employee and owner status in this case, accordingly, may well be applied to a wide range of partnerships, professional or otherwise. In a 1984 decision under Title VII, Hishon v. King & Spalding,[42] involving a law firm as employer, the Supreme Court held that the firm's consideration of the employee-associate for partnership was a term, condition or privilege of employment subject to the Title VII prohibitions against sex discrimination in employment, without regard to whether a lawyer's status as a partner was a non-employment status, as opposed to an employment promotion. Clackamas appears to create a formula to resolve this open question, although the formula itself is highly problematic.

The burgeoning significance of the owner/employee question is indicated by the fact that the Supreme Court has already granted review in case raising a similar issue under ERISA, which will be decided this term.[43]

Differentiating owners from employees, as opposed to employees from independent contractors, is not the only area in which the Supreme Court has interpreted similar statutory language differently regarding who qualifies as a statutorily covered "employee." In fact, the FLSA contains the same language as the ADA and ERISA to define "employee".[44] However, in light of a separate definition of "employ," as meaning "to suffer or permit to work",[45] statutory coverage has been interpreted considerably more broadly.

41 Ibidem at 1678.

42 467 U.S.C., §69 (1984).

43 In re Yates, 287 F.3d 521 (6th Cir. 2002), cert. granted sub nom Yates v. Hendon, 123 S. Ct. 2637 (2003).

44 29 U. S. C., 203 (e) (1) ("any individual employed by an employer").

45 Ibidem, §203 (g).

The FLSA has been interpreted as incorporating an "economic realities" test, an approach intended to sweep more broadly than the common law master-servant formula. Six factors are often relied on by courts, in a totality of the circs test in which no single factor is dispositive:

a) The nature and degree of the putative employer's control as to the manner in which the work is to be performed.
b) The putative employee's opportunity for profit or loss depending on his or her managerial skill.
c) The putative employee's investment in equipment or materials required for her or his task, or her or his employment of other workers.
d) Whether the service rendered requires a special skill.
e) The degree of permanence and the duration of the working relationship.
f) The extent to which the service rendered is an integral part of the putative employer's business.[46]

This test is intended to sweep more broadly than the common law master-servant test, or as one well-known, conservative judge explained, "to defeat rather than implement contractual arrangements" and to "include workers who possess only dedication, honesty and good health", i. e., limited human capital and little or no physical or financial capital.[47] "Economic dependence", a term found nowhere in the statute itself, long has been regarded by the courts as the sine qua non of employee status under the FLSA. Although it is sometimes characterized as a seventh factor in the six factor test, as one court explained, "economic dependence is more than just another factor. It is instead the focus of all the other considerations," which should merely be treated as "tools to be used to gauge the degree of dependence of alleged employees on the business with which they are connected".[48]

Judicial interpretations of the economic realities test, however, have hardly been static over time. With the passage of time since the 1938 enact-

[46] See, e. g., Secretary of Labor v. Lauritzen, 835 F. 2d 1529 (7th Cir. 1987); Donovan v. Dial-America.
[47] Ibidem (Easterbrook, J., concurring).
[48] Ibidem.

ment of the FLSA, the judicial trend has been toward increasingly narrow interpretations of the economic realities test, until in some federal courts, it hardly differs from the common law master-servant formula.[49] The increasing conservatism of the federal judiciary over two decades of predominantly Republican presidential appointments has undoubtedly contributed to this trend.

C. The choice between "master-servant" and "economic realities"

Although litigants routinely urge courts construing statutes to adopt an economic realities rather then a master-servant approach to interpreting the law as to coverage, there is another reason why the courts refuse to do this, at least as to federal statutes. In the early years of construing New Deal depression-era social legislation, the Supreme Court adopted an economic realities approach not only in construing the FLSA, but also in construing the Social Security Act and the National Labor Relations Act. As to these other two statutes, however, Congress amended the laws to expressly overturn the Supreme Court's interpretation and adopt a common law master-servant based approach. Absent legislative amendment, neither of these federal laws can be re-interpreted. Moreover, this history lays a reasonable foundation for the Supreme Court's general interpretative approach, however problematic as a policy matter.

D. Labor intermediaries and joint employers

The courts have had especially great difficulties in cases involving labor intermediaries, and possible joint employer status.[50] Although some of these cases date back many years, they are plainly growing more numerous today. Such cases arise under the FLSA and state wage statutes, where courts usually attempt to apply the economic realities test to what is often a three-sided relationship, in which the worker's dependent status may be

[49] Compare, e. g., Donovan v. Brandel, 736 F. 2d 1114 (6th Cir. 1984) (holding seasonal, migrant pickle harvester farmworkers to be independent contractors) with Lauritzen, 835 F. 2d 1529 (7th Cir. 1987) (holding same type of workers to be landowner's employees).

[50] See, e. g., Torres-Lopez v. May, 111 F.3d 633 (9th Cir. 1997); Donovan v. Dial-America.

clear, but it is harder to determine upon which of two, or both of two putative employers the worker is dependent.[51]

In addition, these cases arise under many other labor statutes, where the master-servant common law formula, rather than the economic realities test, is applied. They are especially common under equal employment laws, particularly when the worker is nominally employed by a temporary labor supply agency but works on the premises of the business hiring the labor services, or when a business employs the workers of a subcontractor regularly to perform work on its own premises, often with the user of the labor exercising shared aspects of supervision, particularly assignment of work to the employee. Sexual harassment cases are particularly prominent among these, since the worker is invariably harassed on the user employer's premises, by supervisors or rank and file workers directly employed by the user employer, with little or no role played by the worker's nominal employer, the labor supply agency. The courts have varied widely in their response to these cases, although some, at least, have been willing to embrace a functional approach. These courts have accepted the central notion that a business which enjoys the incidents of supervision such as assignment of work over a worker on the business' own premises, is an employer to the extent that the mode in which the company has exercised that authority would violate the labor law were the worker directly employed by that business. Although this functional approach holds considerable promise, many courts have failed to apply it under various statutes, and it has almost entirely been used only in the common situs situation, i. e., when the subcontracted employee is working on the labor user business' premises, side by side with workers who are unambiguously employees of the user employer.

Although these problems of business "escape" from the strictures of the labor laws are significant and spreading, there are important countervailing forces in operation, which should also be reviewed. Labor laws continue to allow employers a great deal of flexibility, at least in international comparison; moreover, the legal incidents of the employment relationship confer other benefits upon employers may induce them to continue openly to employ their own employees, rather than seek to use the services of outside contractors.

[51] See, e. g., Liu v. Donna Karan Int'l, Inc., 6 Wage & Hour Cas. (BNA) 1142 (S. D. N. Y. 2001).

III. BENEFITS AND BURDENS OF THE "EMPLOYMENT RELATIONSHIP" CHARACTERIZATION COMPARED TO A CONTRACT FOR SERVICES

1. Ease of termination of the employment relationship

Unlike many other countries, in every state of the U.S. except Montana, the employment relationship is presumed to be "at-will". This means that either party may terminate the relationship for any reason or no reason, without any legally specified notice, and without any legally mandated severance payment.

There are some important exceptions to this rule, which should be noted briefly. First, employment may not be terminated for a reason prohibited by statute. The many reasons prohibited under federal and state anti-discrimination law and anti-retaliation laws previously have been outlined. In addition to these grounds prohibited by statute, in a majority of states today, common law jurisprudence prohibits discharge on grounds which violate public policy, even when there is no express statutory provision on point. Such cases for the most part arise in connection with employees performing a civic duty or obligation arising outside the employment context, which the courts wish to ensure will continue to be freely performed, although this doctrine may also be applied in connection with older employment-related laws which do not include an anti-retaliation provision. Courts have allowed workers to sue for common law tort damages when their employer fired them for filing a claim for benefits under the state's workers' compensation law for occupation injury or illness. There are also many cases in which the employer fired the worker for testifying truthfully under oath (but adversely to the employer's interest) in legal proceedings. This doctrine has also been applied to cases in which the employee notifies the public authorities of a violation of law being committed by the employer, such as the case where a dairy truck driver instructed by his employer to delivery spoiled milk to a retail store, instead drove the truck to the public health authorities. Several states have now enacted "whistleblower" statute, codifying this latter body of law.

Despite this growing set of exceptions to the employment-at-will doctrine, however, by and large, the employer remains free to terminate employment, not only for economic reasons, and for cause relating to the individual worker's job performance or activities, but for wholly arbitrary reasons.

It is relatively uncommon, outside government civil service employment, unionized employment covered by a collective bargaining agreement, and university professorships, for employees to have a formal written employment contract containing job security specifications or a commitment to employment for a fixed term. There is a body of judicially developed common law doctrine in many states, recognizing a contractual obligation not to terminate employment without good cause on the basis of unilateral acts of the employer, such as language contained in an employee handbook or manual or oral promises of job security made when the worker was hired, or agreed to turn down a position offered at another employer. However, employers can easily avoid becoming contractually bound, even in such states, either by including a prominent disclaimer of job security commitments within the documents they provide the employee, or by simply refraining from making any job security promises, either written or oral.

The long and short of this is that the main reason for employers in many countries to avoid creating an employment relationship does not exist under U.S. Employers are relatively free to end employment on a moment's notice, either for economic reasons or otherwise.

Independent contract relationships

The presumption that employment is at-will does not apply to ordinary contractual relationships, including independent contract relationships for the performance of services. Whether written or oral, such a contract will be construed to effectuate the intent of the parties. Special judicially-developed rules about separate consideration necessary to make binding a promise not to terminate except for good cause, vestiges of an earlier period which are still in effect in the employment-at-will doctrine of some states, are inapplicable to an independent contract for the performance of services. Absent a duration clause, or hiring to complete a designated task, a court is likely to interpret the duration as being for a reasonable period of time, in light of all the circumstances.

In some fields, professional service rules will operate akin to the employment-at-will rule. For example, it is usually held that a client has the right to discharge his or her lawyer at any time, for any reason, without notice; similarly a patient may change physicians without advance notice. Bills for services rendered, however, must be paid, and because the professional service provider often performs work outside the presence of the client or patient, the bill may well include time spent of which the client is unaware.

For the most part, labor law does not recognize the employee's cumulative human capital investment in the employment relationship when it permits termination without notice or any obligatory severance pay. The reasonable notice requirement, and some aspects of professional service compensation law, do take account of these interests in durational service arrangements. For non-professional service contracts, ordinary rules of law regarding business contracts are likely to be applied, even if the nature of the relationship is that of one individual performing work on behalf of a business, i. e., a contract for the performance of individual services.

2. Work site closures and mass reductions in force

By way of exception to the general rule, the federal Worker Adjustment Retraining Notification Act (WARN Act) requires employers to provide either workers or, if organized, then their union representative, with at least 60 days advance notice before instituting a mass reduction in force. Failure to provide the requisite notice requires the employer to pay the workers at their normal pay rate in place of the notice. This law contains exceptions which Congress intended to be very narrow ones; however, many employers have asserted these exceptions with little challenge to their validity, according to a recently released federal study. A few states, including Maine, impose more substantial severance pay obligations upon employers in the case of closure of a plant. In unionized facilities, the employer is under a duty to bargain with the union over the effects of the plant closure upon the workers, to seek special severance benefits or job transfers to another facility of the company, and, if the decision turns upon labor costs, the employer may have a duty to bargain with the union over a decision to relocate or subcontract operations.[52] In addition, some special provisions established in the Older Workers' Benefits Protection Act, apply to limit the employer's ability to discriminate on the basis of age in dispro-

[52] See Fibreboard Paper Prods Corp. v. NLRB, 379 U. S. C., 203 (1964); First National Maintenance Corp. v. NLRB, 452 U.S.C., 666 (1981); Dubuque Packing Co.

portionately selecting older workers to terminate or induce to retire in the course of a mass reduction-in-force, and to prevent abuses in pressuring older workers to retire in the course of mass downsizings.[53]

In summary, unlike the employer's nearly unfettered freedom individually to terminate the employment relationship, there are a few restrictions upon mass employment terminations or closure or relocation of facilities. Nevertheless, these limitations mostly require advance notice, and impose only a modest burden upon an employer whose business interests dictate a reduction in the workforce or in plant capacity.

3. Modification of terms of employment

If termination of employment is flexible under U.S. labor law, modification of terms of employment is even more so. The implication of the employment-at-will doctrine for modification of terms of employment are nearly as significant as those pertaining to outright termination of employment. Because in nearly all cases, the employer is free to terminate the relationship outright, without notice, the employer is also free to prospectively modify terms of the employment relationship. Thus, although the employer cannot reduce the pay rate for work already performed, the employer can announce that effective tomorrow, the pay per hour of work will be decreased 10%. Absent a written promise to the contrary, or an oral promise deemed binding by the state courts, the employer will be free to pay the lower rate, although of course, the employee will be free to announce that this rate is unacceptable, and to quit on the spot.

Some state courts gone beyond implying the existence of a contract not to terminate employment without good cause based upon verbal promises by employer agents or written company handbooks or manuals, particularly when accompanied by employee reliance. Courts in these states may require additional consideration by the employer or otherwise make it difficult for the company to modify their job security promise. Virtually no courts, however, have applied this analysis to prospective alteration of wages, benefits, or other terms of employment.

Unlike outright termination, there is no notice rule applicable to mass, as opposed to individual, modification of terms of employment, whether or

[53] 29 U.S.C.

not in the employee's favor. From the point of view of the individual performing the work, it is also not so clearly advantageous to wear the title, "independent contractor", notwithstanding American mythology in favor of "being your own boss", Quite apart from enhanced economic insecurity and higher social security taxes, performing work as the proprietor of an independent contracting business hampers or precludes entirely economies of scale essential to obtaining good health insurance coverage at favorable rates and advantageous retirement plan treatment. Moreover, the individual in most cases, cannot afford the quality of legal advice necessary to take advantage of the balanced vantagepoint of the commercial contract form, although higher level professional and technical service providers sometimes may.

There is one exception to this analysis, which is the area of employee fringe benefits. ERISA to a modest degree restricts employer ability to modify employee fringe benefit entitlements, particularly pensions, but even there, only to the modest degree that they are already "earned", or "vested". Numeous escape hatches have been carved out even this area, however. On the other hand, in many small businesses, as in the *Clackamas* case discussed above, the principals in the business themselves benefit by creating a tax-advantaged employee fringe benefit plan covered by ERISA.

In summary, employers enjoy almost as much flexibility in establishing, changing, and ending the employment relationship and its incidents as they do in an independent contract relationship; to some extent, the law may be more favorable to them in the employment format.

4. Workers' compensation

Employers are in most states required to obtain private or public insurance coverage and are subject to the state's no fault workers' compensation insurance system. Although a modest, per employee payroll cost is added for this coverage, for many employers the workers' compensation system operates to their advantage. Employees covered by the system are normally precluded from suing their employer for negligently caused harms under ordinary common law tort principles. Workers' compensation is a form of strict liability, so that the employee will be able to recover benefits so long as the requisite connection between employment and the harm to the worker is demonstrated. Defenses based on the causally contributory negligence of the injured employee or a co-worker, sometimes available in tort litigation, are unavailable under workers' compensation statutes. On the other hand, employees are able to recover only relatively modest compensation for their injuries under workers' compensation schemes, which usually incorporate a regulated schedule of benefits for temporary and permanent, partial and total forms of disability. Recoveries in negligence suits may include substantial amounts of compensatory damages not only for medical and rehabilitation expenses and lost past and future earnings, but also for pain and suffering. Willful, wanton, recklessly caused harms may entitle the injury victim to punitive damages. A business which uses independent contractor's employees on their own premises may risk tort liability rather than modest workers' compensation liability for injuries caused by the user employer's negligence. Some states, however, have modified their workers' compensation laws to take account of the common situs situation in construction, and could readily extend this approach to other industries.

5. The duty of loyalty, covenants not to compete, control over trade secrets and intellectual property

The area in which employers can least afford to eliminate the employment relationship are those in which the common law permits them greater control over proprietary and competitive information, both for the duration of the employment relationship and beyond. These areas are complex, for the most part are governed by state statute and common law, and can only briefly be sketched out here.

Common law jurisprudence in many states imposes upon each employee a duty of loyalty to the employer for the duration of the employment relationship.[54] Although "moonlighting," i. e., working in a part-time second job or self-employment after regular working hours is not illegal, an employee may not compete or otherwise act against her or his employer's interests. As to matters connected to the subject matter of the employment, it is often said, the employee must act solely in the interest of the employer.[55] This includes industrial espionage, selling trade secrets to

[54] See generally, e. g., Benjamin Aaron & Matthew Finkin, The Law of Employee Loyalty in the United States, 20 Comp. Lab. L. & Pol'Y J. 321 (1999).

[55] See, e. g., Jet Courier Serv. v. Mulei, 771 P. 2d 486 (COIO. 1989) (en banc).

a competitor, using confidential business information to start one's own business, and in some circumstances, disparagement to third parties of the employer's products or services. The higher level managerial employee may also be subject to additional fiduciary duties to the firm. Either under that rubric, or under separate statutory provisions, employees are required to protect employer trade secrets, another slippery term which receives divergent interpretation among state courts. The employer may also contract with employees for additional protections regarding preservation of trade secrets.

Trade secret protections may be created between independent contracting individuals or firms, and so long as reasonable efforts such as contractual confidentiality clauses, are entered into, a business may preserve its secrets while employing outsider contractors' labor services rather than the firms own employees. However, the law does much of this automatically for those employed inside the company, and care and forethought must be exercised regarding contractual coverage with outside workers or subcontractors. Moreover, once the information becomes generally available, or it is found that reasonable efforts to preserve confidentiality were omitted, the information is has lost its protection as a trade secret.

When employees leave to start up their own business, questions arise not only about their solicitation of customers of their soon to be former employer, but also of coworkers to join their new competing firm, either in preparation for starting up their new business, or after leaving their prior employment. These questions, too, are sometimes addressed under the rubric of the duty of loyalty, with mixed results depending on the state, as well as factual details.[56]

Although the law favors competition, and free worker mobility and use of their own human capital, and disfavors restraints on the worker's participation in the labor market. Nevertheless, in many states, employers are permitted to negotiate with their employees for agreement to a covenant not to compete, which will bind the employee after termination of employment. The courts will not specifically enforce a commitment to work for a set duration for a given company, either in the form of employment or as an independent contractor; both at common law and under the Thirteenth Amendment to the U.S. Constitution, which prohibits involuntary servi-

56 Idem.

tude. When a worker contracts to work for a fixed term, the most a business can win is either damages for the breach, or a negative court order, prohibiting an employee from working elsewhere, usually for a competitor. At a result, employers sometimes negotiate covenants not to compete either to enhance protection of trade secrets, or to bolster the worker's durational work commitment.[57]

The extent to which such contract clauses are enforceable and serve this purpose varies widely. State courts generally require these clauses to be "reasonable" in scope, in terms of time duration, geographic scope, and occupational or industrial scope. The employee's need to continue gainful employment and to use her or his accumulated knowledge, training, and skill, as well as society's interest in a free flowing labor market and competition in provision of services is balanced against the employer's legitimate interest, which is usually viewed as not including preventing competition, but only guaranteeing a greater degree of security against employee disclosure of trade secrets and other proprietary business information. Some jurisdictions, particularly California, disfavor these clauses, and will not enforce them, but most will, provided they are reasonable. Others disfavor them but will enforce them under some circumstances. Many states more readily enforce such covenants when the employee quits, but rarely do so if the employee is fired by the employer.

As a rule, an independent contractor does not owe any duty of loyalty to the party for whom it performs work, unless they legally qualify as an "agent" or "fiduciary." Indeed, it is expected that the independent contractor will work for other businesses, which may include competitors, in the absence of contractual provisions to the contrary. The independent contractor will not be deemed to be a fiduciary under normal circumstances. Contractual restraints on competition may well receive less favorable treatment in the independent contract relationship, as opposed to the employment relationship. In the case of very large businesses, antitrust and unfair competition law may impose further limitations on lawful contract clauses, limitations that are inapplicable to the company's own employee workforce and their internal labor market.

Copyright law provides employers with automatic title to works produced by employees in the course of employment, absent a written con-

[57] See generally, e. g., Gillian Lester, Restrictive Covenants, Employee Training, and the Limits of Transaction Cost Analysis, 765 IND. L. J. 49 (2001).

tract to the contrary, whereas the independent contract worker will hold title to the copyright, even of a specifically commissioned "work for hire," unless the commissioning firm bargains contractually to obtain title in a written instrument.[58] In New York Times Co. v. Tasini,[59] the Supreme Court upheld the contention the freelance writers for the newspaper were independent contractors, and had retained their copyrights for use beyond the immediate print publication of their articles in the newspaper treated as a collection. The result was that the newspapers' electronic republication of their articles through LEXIS-NEXIS infringed the freelancers' copyrights. When employees produce copyrightable work, the employer holds the interest for all purposes, including those unforeseeable at the time the work was produced. Because the hirer of independent contract labor must specifically contract for copyright in the work, it is more difficult to contractually cover future contingencies.

The law regarding inventions is more complex, depending in part on whether the invention is patentable.[60] When the employee was hired to do perform the research that leads to a patentable invention, the patent is normally that of the employer; however, when an employee who uses the firm's resources to invent something falling outside the scope of the employee's activities, the employee owns the patent. The employer, however, obtains a "shop right" in effect a compulsory, royalty-free license to manufacture and use the invention; this right, however, is limited to the employer and cannot be assigned to third parties.[61] Again, this is an area that can be addressed when outside contractors are employed, but it requires detailed contractual attention and perceptive drafting against future contingencies.

[58] 17 U. S. C. 101, 201 (b). These provisions were construed in Community for Creative Non-Violence v. Reid, 490 U. S. 730 (1989). See generally, e. g., Catherine L. Fisk, Authors at Work. The Origins of the Work-for-Hire Doctrine, 15 Yale J. L. & Human. I (2003).

[59] U. S. (2001).

[60] See generally, e. g., Catherine L. Fisk, Removing the "Fuel of Interest" from the "Fire of Genius": Law and the Employee-lnventor, 1830-1930, 65 U. CHI. L. REV., 1127 (1998).

[61] See, e. g., Francklyn v. Guilford Packing Co., 695 F. 2d 1185 (9th Cir. 1983).

6. Other consequences flowing from core employment relationship assumptions

The historic commentator most cited for establishing the prevalent employment-at-will basis of U. S. employment relations, summarized the assumptions built into U. S. common law about obligations of the employee embedded in common law master-servant status notions about the employment relationship: “there is an implied obligation to enter the master’s service and serve him diligently and faithfully, to obey all his reasonable commands, treat him respectfully, ...and to perform the duties incident to his employment honestly, with ordinary care, and due regard to his master’s interest and business”.[62] In many respects, these notions persist in judicial interpretations regarding employment disputes, whether based on claims of violation of statute, or common law contract or tort.

Employee expectations of privacy on the job are often deemed non-existent or non-enforceable. U. S. employers, for example, have generally been held entitled to monitor employee e-mail on the workplace server system, even though third party privacy interests may also be involved. In most states, employers may require employees to undergo drug testing, even if it is unrelated to hazards on the job.

Common law liability for intentional torts such as invasion of privacy and intentional infliction of emotional distress by extreme and outrageous misconduct are often held inapplicable to behavior in the course of employment, or the understanding of how deviant employer conduct must be to violate the norm and become tortuous is far more expansive in employment than in other contexts. When an employment relationship is structured as one of independent contract, however, courts may follow the general line of precedents rather than those specific to employment. Actions taken internally to a business are usually treated as a left hand shaking with the right. No external event has taken place. This is sometimes held to preclude tort liability for what would otherwise be defamatory statements, made between company insiders. Many legal privileges protecting corporate information from disclosure in connection with litigation likewise depend on the material never having been revealed outside the business entity. When a business chooses to become a “virtual corpora-

[62] H. G. Wood, A Treatise on the Law of Master and Servant, 165-166 (2a. ed. 1886) (quoted in Aaron & Finkin, op. cit., 55).

subcontracting its operations to various independent contractors, either individual or corporate, these legal protections disappear.

A business which transforms its workers into independent contractors may forfeit the solicitous attitude of the courts, and be limited to ordinary contract interpretations. This includes the settled rule, often ignored in construing employment contracts, that ambiguous terms in a contract should be construed against the drafter. The labor user is entitled to receive exactly the services for whose performance the worker contracted, but depending on how the contract is written, may not be permitted to reassign the worker or drastically alter the nature of the work to be performed.

In addition, the ordinary rule of contract interpretation holds that in every contract there is to be implied a covenant of good faith and fair dealing, that neither party shall exercise discretion afforded under the contract to preclude the other side from obtaining the benefit of their bargain. In the employment context, however, most jurisdictions have refused to apply this doctrine, or have narrowed it, to take account of the employer's entitlement to terminate the relationship at will, which often in fact permits the employer to defeat the employee's retention of significant aspects of the bargain underlying the employment relationship. Once the relationship is relabeled one of independent contract, both parties are subject to the usual implied covenant, although those employing labor under the independent contractor rubric probably act without taking this fact into account.

In short, the business needing to use the labor of others may have greater legal benefits from treating the relationship as one of employment rather than one of independent contract.

IV. SPECULATIONS ABOUT SOLUTIONS TO THE WORK RELATIONSHIP PROBLEM

This section will ruminate on solutions to the problem of fairly and appropriately characterizing work relationships for purposes of labor regulation. These are preliminary thoughts rather than well-developed recommendations, and should be regarded in that light. The thrust of this paper is that the demand for "flexisecurity" commonly voiced in Europe does not make sense for the United States, where the labor law system already provides employers with more flexibility regarding terms and conditions of work performance than most of the European flexibilization proponents would propose. American flexibility is already too extensive at the expense of job and income security, and the social welfare system, with its increasing holes and blossoming federal and state budget deficits, is unlikely to pick up the slack.

The problem of differentially regulating dependent work relationships is an extremely difficult one in the United States. For some businesses, the "carrots" of pro-employer labor law will outweigh other economic incentives either to turn their employees into independent contractors, to disaggregate their business into contractually inter-related but legally independent units, or to subcontract discrete components of the work previously performed by firm employees or to hire labor supplied through a labor supply agency. This is especially true for businesses dependent upon firm specific human capital investment, with a long term view toward their work relations and the development of the enterprise. Such a longer time horizon, however, is rapidly vanishing from the U. S. scene in the face of rapacious global competition.

Another proposal, based on models from Canada and Europe, is to move from the binary, employee-non-employee category scheme to one recognizing an in-between category of "dependent worker". I find this proposal has little to recommend it in the U.S. context. To the extent that employers cannot bear the modest burden of existing labor regulation, they are equally likely to shirk the more limited burdens of a new, hybrid category. Moreover, it is difficult to justify reducing the minimal levels of protection workers denominated "employees" have today. Inevitably, creating a new middle category would shift some additional current employees into that category, and further increase competition against the most marginal workers at levels of protection that fall below the minimum for sustainability of the workforce. Moreover, the "third way" proposals do little to address the joint employer/labor supply problem. Until that is addressed, some businesses will outsource more and more operations to contract labor, whether directly or indirectly supervised by them.

One proposal is to impose some requirements, such as the minimum wage, upon all work, however contracted. This would serve the purpose of ensuring compensation for all labor at a level assuring sustenance and reproduction of the labor supply at a decent, if basic standard of living, and would meet the purpose of the FLSA and state wage laws not only to prevent workers from bargaining unsustainably low wages for themselves, but also to prevent such unfair competition by either workers or those employing their services. There are at least two problems with this approach, however. First, the truly self-employed entrepreneur, one who opens their own small retail establishment or provides professional services billed to numerous clients on a per unit basis or as a percentage of recovery, is almost inherently unreachable for this purpose. In addition, the possibility of monitoring for compliance is intractable. Yet attempting to draw a line which excludes such truly self-employed while including those who are in form self-employed but functionally work almost entirely for one business, poses additional problems, particularly when businesses are in the start up phase, and have few if any clients. Nor does this approach lend itself to solution of the "owner-worker" dual capacity problem, or the "joint employment" problem, particularly when labor supply firms intermediate the work relationship.

On the other hand, something similar to this approach has had some success under anti-discrimination law. Besides the modern employment discrimination laws noted previously, civil rights legislation dating back to the pos-Civil War Reconstruction Era of the U. S., amended in 1991 to clarify and extend the reach of the statute,[63] prohibit racial discrimination in all forms of contracting, including but not limited to employment contracting. This language has been applied, for example, in the context of physician's hospital privileges, a non-employment relationship that is essential to the functioning of the doctor's professional practice. In at least a few cases, the statute has been applied against discrimination in independent contracting relations, as well as in something akin to a join employment or three-sided work relationship. The coverage of all forms of contracting obviates the need to address the employment or work-based nature of the arrangement. To some extent, certain non-employment portions of the Americans with Disabilities Act may also be used to reach contractual relationships beyond employment.

The problem with generalizing from these laws to other labor laws, especially labor standards legislation, is that these laws are applicable only to decisions based on unlawful motive. This allows the courts to avoid intervening in every type of conceivable contract. It is difficult to imagine a legislature extending this principle to the truly self-employed, particularly when lawmakers are already excluding small employers from many forms

[63] 42 U. S. C., 1981.

of labor regulation. The U.S. enthusiasm for entrepreneurship and self-exploitation suggests that solutions along this line are politically infeasible, apart from the monitoring and enforcement problems noted above.

Another set of solutions would take the FLSA economic realities test, perhaps expanded a bit, and apply it across the board to all labor legislation, federal or state. This has the appeal of a holistic solution, and one that shows promise of addressing the joint employer/labor intermediary situation to some extent. Leaving aside the constitutional and practical infeasibility of actually enacting and implementing a truly uniform approach at both the state and federal level, this approach suffers from two further problems which any solution must address.

The first is failure to effectively enforce the law currently on the books. Government-conducted studies strongly suggest wholeale violation of clearly applicable minimum wage and overtime standards. In one study, the U.S. Department of Labor found that only 52% of garment industry employers were complying with the requirements of the FLSA.[64] Another study of agricultural employers' compliance with wage and hour laws, including FLSA and a separate statute applicable to migrant agricultural labor, found that not a single one of the poultry employers studied were in full compliance.[65] In health care, a Department of Labor-sponsored survey found that only 40% of employers of nursing home workers were found to be in full compliance. In retail and service industries, the Labor Department has not conducted a survey, but litigation rates indicate widespread levels of noncompliance. More than half of all FLSA compliance actions brought by the federal government were in these industries.[66]

The enforcement problem is intractable, even under present law. Small businesses are too numerous for government to effectively monitor more than the smallest fraction. Although employees have a private right to sue under nearly all labor laws, when the amounts at stake are small, it is difficult for them to obtain legal representation even when the claim is clearly

64 U. S., DOL, 2001 New York City Garment Compliance Survey (Mar. 2002) http://www.dol.gov/opa/media/press/opa/NewYork Surevy.htm.

65 Wage and Hour Division, U. S. DOL, 1999-2000 Report on Initiatives (Feb. 2001). See also U. S. DOL, Annual Report FY 2001 (Feb. 2002); Office of Program Economics, U. S. DOL, Findings from the National Agricultural Workers Survey (NAWS) 1997-1998, Research Report No. 8 (Mar. 2000).

66 See Howard Wial, Keystone Research Center, Minimum-Wage Enforcement and the Low-Wage Labor Market 18 (1999) http://mitsloan.mit.edu/iwer/WialWPl l.html.

meritorious and the statute, contrary to the generally applicable American litigation rule, permits a plaintiff who wins to recoup her or his costs and attorneys fees from the employer. Most labor laws provide for workers to win costs and attorneys' fees as part of their recovery upon winning the lawsuit, and do not permit employers who win to recover absent abusive litigation by the worker. Nonetheless, fee awards tend to be proportionate to the amount at stake in the lawsuit rather than the time necessary to properly pursue it, so it is uneconomical for lawyers to handle many of these cases. Even when they do, usually on a pro bono or non-profit volunteer basis, winning the lawsuit is only the first obstacle. Small and marginal businesses are harder debtors to recover against than the average individual bank loan borrower who goes into default. When they have corporate form, the shell will be depleted of its limited assets. Although some state laws have been interpreted or applied by state courts to allow for individual liability of the business owners in certain cases, adding a whole post-adjudication proceeding devoted to skip tracing, locating assets, and other forms of secondary recovery litigation will make many more cases totally uneconomical. For these purposes, it does not matter whether the small business is deliberately operating illegally, in the informal sector, or whether the business is purportedly complying with the law, but just fails to pay its workers properly or timely, particularly when the business finances become strained.

Second, the cause of much academic complaint is the judicial evisceration of the economic realities test itself.[67] Whether new statutory language could be written which would effectively contrain the courts against the inclinations of many members of the judiciary is questionable. Historically, it took Congress three tries and thirty years before the Supreme Court accepted the notion that labor is not a commodity in interstate commerce, and took the federal courts out of the business of enjoining strikes in labor disputes. A similar trajectory on labor regulation coverage of the work relationship, however formulated, is imaginable, although one hopes it will not develop.

A solution might involve using carrots as well as sticks to encourage compliance, especially by those small businesses against whom litigation is economically difficult. Perhaps a special business start-up tax or security

[67] The work of Marc Linder, note 1, could be described this way, notwithstanding my sympathy for his position.

deposit for wages owed to workers would accomplish this purpose, although the price would be heightened barriers to legitimate entry of new small business, which might be anathema to devotees of American entrepreneurial initiative. It could also have a disparate impact against precisely those disadvantaged segments of the laborforce, racial minorities and immigrant populations, for whom social policy would otherwise wish to lower barriers to entry. The carrot and stick approach could also be used to leverage the benefits of employment relationship categorization, for example, for employee benefit purposes under ERISA, to induce more employer acceptance of the same characterization under other laws. This is not quite the same as trying to enact a uniform employment relationship definition. Rather, it would stop a business to deny that workers were employees for all statutory purposes once the business had so categorized them for purposes falling to the firm's advantage.

In one area, I would hope to see a fairly uniform interpretation develop. That is the joint employer or labor intermediary situation. There is no logical reason why the status of employer should not follow the exercise of employer-like supervisory authority over workers, under every labor statute. This would have the further advantage of permitting workers to negotiate, at least individually, with the party actually controlling the terms of their employment, directly in on the job instructions, and indirectly through economic leverage exercised over the subcontractor or labor supply firm. The problem here is drawing a line around this. It could clearly apply in the common situs situation, where the supplied worker performed services regularly on the putative employer's premises, and could cover the supposed independent contractor as well, although the economic realities test, properly applied, should already reach most such cases. The harder question is about workers who perform their work off site, or only occasionally on site, but nevertheless are subjected to direct assignment, task direction, and monitoring of performance by the labor user firm. I would treat them, as well, as employees of the user firm, in addition to the supplier or contractor, so long as the user exercised sufficient supervisory authority over their work performance.

Implicit in many proposals for change is the idea that to a significant extent, businesses are restructuring themselves, disaggregating themselves, motivated in whole or part by the labor law consequences. I would, by analogy to NLRA labor law avoidance motive cases, treat such corporate transactions as unlawful labor law avoidance maneuvers, and to the extent possible, nullify them or undo them. However, the experience under the NLRA indicates that it will be exceptionally difficult to prove such motive. Given that the economic consequences for workers are no different regardless of why a stable business transforms itself into a virtual corporation, this approach may be necessary and desirable but is plainly not sufficient. On the other hand, the notorious Wal-Mart cases suggest that even some extremely large and successful businesses are now subcontracting janitorial and other operations, with very low contract payments, where the payment level itself is evidence that the business expects its subcontractors to violate labor laws in performing their work.

There are those who are extremely enthusiastic about the convergence of employment and independent contracting, not because they believe in tipping the balance of power in favor of employers, but because they believe a "high velocity labor market" with low barriers to movement between firms, encourages maximization of human capital and bargaining position for the workers as well as optimizing productivity and development among employers and the industry as a whole. Alan Hyde's work on high technology professionals working in Silicon Valley exemplifies this genre.[68] Assimilating such privileged workers to independent contractors makes sense from the point of view that the rationale for differentiating employees from independent contractors in the first place is that the former have all their human capital investment eggs in the one basket of long term employment with a single firm, while contractors are supposedly diversified by dealing with several customers or clients. High velocity employment in which workers move to a new employer every few years, means these workers are diversified sequentially, rather than contemporaneously, and that the structure of their labor market, like the supposed structure of an independent contractor's market, renders it easy for them to terminate one relationship and form a new one, a risk diversification approach to income security.

It may be that this model is spreading throughout large segment of the U.S. labor force, but it is hardly true that most workers have the human and intellectual capital to diversify their risk the way that Silicon Valley workers have until now. Assimilation of all workers to the independent contrac-

[68] See Alan Hyde, Working in Silicon Valley: Economic and Legal Analysis of a High-Velocity Labor Market (2002).

tor, i. e., laissez faire model, then, is hardly warranted on that basis. More important, the Silicon Valley culture worked for workers as well as employers during a boom and growth period in the early days of the industry. It is far from clear that these workers are so satisfied going forward. The newspaper articles screaming about outsourcing of growing volumes of high tech work to India, for example, suggests that these workers are doomed in the near future to find their bargaining position more similar to that of other workers in the U.S.