Part One

The Regulation of the Employment Relationship

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Chapter **One**

The Regulation of Employment

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Opening Scenarios

SCENARIO 1

1 Scenario

Emma Bina is working as a research scientist at a laboratory when she is approached with an employment offer from a competing laboratory. The competing lab director offers Emma nearly double her present salary and superior research equipment and opportunities. The lab director tells Emma that she can remain employed with the new company as long as she does satisfactory work. Emma accepts the offer, sells her house, takes her dog and cats and moves to the new state, buys a new house, and settles in. Emma's first two evaluations are superior. Then, six months after arriving, Emma is terminated and the employer offers no explanation. Emma sues for unlawful termination. Does she win? Why or why not?

SCENARIO 2

2 Scenario

Mark Richter is about to retire as a candy salesperson when he closes on a deal the candy company has been trying to land for a long time. Just before Mark is to collect his substantial commission, he is terminated. Does Mark have a basis on which to sue for unlawful termination?

SCENARIO 3

3 Scenario

Jenna Zitron informs her employer that she has been summoned to serve jury duty for a week. Though rescheduling her duties is not a problem, Jenna is told by her employer that, if she serves jury duty rather than trying to be relieved of it, she will be terminated. Jenna refuses to lie to be relieved of jury duty. Does Jenna have a basis on which to sue for unlawful termination?

INTRODUCTION TO THE REGULATORY ENVIRONMENT

How is the employer regulated? How much can Congress or the courts tell an employer how to run its business, whom it should hire or fire, or how it should treat its employees?

If an employer wants to hire someone to work every other hour every other week, it should be free to do so as long as it can locate an employee who is willing to enter into such an agreement. Or, if an employer requires that all employees wear a purple chicken costume throughout the workday, there is no reason why that requirement could not be enforced if the employer can find employees to accept the agreement.

The freedom to contract is crucial to freedom of the market; an employee may choose to work or not to work for a given employer, and an employer may choose to hire or not to hire a given applicant.

As a result, though the employment relationship is regulated in some important ways, Congress tries to avoid telling employers how to manage their employees or dictating whom the employer should or should not hire. It is unlikely that Congress would enact legislation that would require employers to hire certain individuals or groups of individuals (like a pure quota system) or that would prevent employers and employees from freely negotiating the responsibilities of a given job. (See Exhibit 1.1.) For example, employers historically have had the right to discharge an employee whenever they wished to do so.

However, Congress has passed employment-related laws when it believes that the employee is not on equal footing with the employer. For example, Congress has passed laws that require employers to pay minimum wages and to refrain from using certain criteria, such as race or gender, in arriving at specific employment decisions. These laws reflect the reality that employers stand in a position of power in the employment relationship. Legal protections granted to employees seek to make the "power relationship" between employer and employee one that is fair and equitable.

Exhibit 1.1 Myths about the Regulation of Employment

1. You have a right to your job.
2. Once you're hired, your employer may not fire you unless if there's a good reason.
3. As an employer, you may not terminate someone unless that worker does something "bad."
4. You have someone working for you whom you really do not get along with; you may not fire that person for that reason alone.
5. As an employer, you may have a rule that, if any employee reports the wrongdoings of the firm to the government, she or he will be terminated.

Is Regulation Necessary?

There are those scholars, however, who do not believe that regulation of discrimination and other areas of the employment relationship is necessary. President Ronald Reagan acknowledged this general philosophy when he enacted Executive Order 12291 in 1981. That order provided that no regulatory action be undertaken *unless the potential benefits to society outweigh the potential costs.* Proponents of this view believe that the market will work to encourage employers' rational, nonbiased behavior.

For example, Title VII of the Civil Rights Act of 1964 ("Title VII") prohibits discrimination based on race and gender, among other characteristics. (For detailed discussion of Title VII, see Chapter 3.) Some economists have argued that rational individuals interested in profit maximization will never hesitate to hire the most qualified applicants, regardless of their race. Status-dependent decisions are inefficient, since they are generally based on the incorrect and naive belief that members of one class are less meritorious than others. These employers understand that if they were to allow their prejudices to govern or influence their employment decisions, they may overlook the most qualified applicant because that applicant was black or a woman. Therefore, they will not let prejudices cause them to hire less-qualified individuals and employ a less-efficient workforce.

However, opponents of this position contend that discrimination continues because often employers are faced with the choice of two *equally* qualified applicants for a position. In that case, the prejudiced employer suffers no decrease in efficiency of her or his firm as a result of choosing the white or male applicant over the minority or female applicant. Therefore, economic forces do not afford absolute protection against employment discrimination where the discrimination is based on race, gender, national origin, or other protected categories.

WHO IS SUBJECT TO REGULATION?

The issue of whether someone is an employer or employee is a critical one when it comes to regulation and one that depends on a variety of factors. (See Exhibit 1.2.) Business decisions made in one context, for instance, may give rise to liability when there may no liability in another (depending on factors such as the size of the business organization). In addition, defining an individual as an employee allows that person causes of action that an independent contractor might not have.

Exhibit 1.2 Myths about Who Is an Employee and Who Is Not

1. An employee is anyone who is paid to work.
2. As long as a person chooses how she will perform her job, she is an independent contractor and not an employee.
3. The one who hires the worker is liable for anything that the employee does in the course of his or her employment.
4. If someone is an employee under one statute, that person is considered an employee under all employment-related statutes.
5. If someone is considered an employer for purposes of one statute, he or she is considered an employer for all statutes.
6. It is always better to hire someone as an independent contractor, rather than as an employee.
7. If a mistake is made in categorizing one's workers, it's no big deal.

In this section, we will examine who is an employer and an employee and how it is decided.

These legal entities are not just the concern of the employer's lawyer and accountant. Temporary help, leased workers, independent contractors, vendors, "outsourcing," and staffing firms have become common elements of the employment landscape. While contingent workers are not "employees," mere labels will not stop a court or administrative agency from determining that the worker has been misclassified, that an employment relationship exists.[1]

Origins in Agency Law

The law relating to the employment relationship is based on the traditional law of master and servant, which evolved into the law of agency. It may be helpful to briefly review the fundamentals of the law of agency in order to gain a better perspective on the legal regulation of the employment relationship that follows.

In an agency relationship, the party for whom another acts and from whom she or he derives authority to act is known and referred to as a "principal," while the one who represents the principal is known as an "agent." The agent is like a substitute appointed by the principal with power to do certain things. The agent is considered as the representative of the principal and acts for, in the place of, the principal. Similarly, an employee is the agent of the employer, the principal. The employee is the representative of the employer and acts in its place. For example, if Alex hires Emma to sell his painting on his behalf, agreeing to pay her a commission if she does so, Alex would be the principal and Emma would be his agent.

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

[1] Kenneth J. Turnbull, "Using Contingent Workers Can Create Complications," *New York Law Journal,* Jan. 12, 2001.

(while the agent remains liable to the principal for the same amount). In other words, if Alex told Emma to sell the painting for any price above $100, and she sells it instead for $80, she would be acting without authority. Emma would be liable to Alex for his losses up to the amount authorized, $20, and Alex would be required to sell the painting for the lower price. An agent is subject to a duty to properly conduct himself in the discharge of the agency transaction, and he is liable for injuries resulting to the principal from his unwarranted misconduct. So if Emma misses an appointment at which someone intended to purchase the painting because she overslept, again she would be liable.

Accordingly, if an employee acts in a way that exceeds her authority, the employer may still be liable to a third party (though the employee would then be liable back to the employer because she exceeded her authority). For instance, assume an employee of a construction company has the authority to charge building supplies at the local hardware store for use in the firm's projects. If that employee went into the hardware store and charged supplies to the firm but then later used those supplies to build her daughter's clubhouse, the construction company (the principal) would still owe the hardware store (the third party) for the supplies since the employee (the agent) represented the company in the purchase, though the employee (the agent) would be liable to the company for the price of the inappropriately purchased supplies.

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

In addition to creating these implied duties for the employment relationship, the principal–agent characterization is important to the working relationship for other reasons, explained in the next section.

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

independent contractor
Generally, a person who contracts with a principal to perform a task according to her or his own methods, and who is not under the principal's control regarding the physical details of the work.

You are hired by a company to do a job. Are you its employee or an **independent contractor**? While most workers may have no doubt about which they are, the actual answer may vary, depending on the statute, case law, or other analysis to be applied. The courts, employers, and the government are unable to agree on one definition of "employee" and "employer," so it varies, depending on the situation and the law being used. In addition, some statutes do not give effective guidance. For instance, the Employee Retirement Income Security Act (ERISA) defines employee as "any individual employed by an employer." As one court said, this nominal definition is "completely circular and explains nothing." The distinction is significant for tax law compliance and categorization, for benefit plans, for cost reduction plans, and for discrimination claims. For instance, Title VII applies to employers and prohibits them from discriminating against employees. It does not, however, cover discrimination against independent contractors. In addition, employers will not be liable for most torts committed by an independent contractor within the scope of the working relationship.

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

of the chapter will discuss the implications of this characterization and why it is important to determine whether a worker is an employee. A later section, "How Do You Determine Whether a Worker Is an Employee?," will present the different ways to determine employment status.

Employer Payroll Deductions

Recall that an independent contractor is someone who performs work for the principal in a relationship where the principal does not control how the job is done. The principal does not oversee the independent contractor or give orders, other than what the final product is to be and what the principal wants. The independent contractor is then free to perform the requested service or act as he or she sees fit. This is in contrast to an employee over whom the employer has much more control about how the job is executed.

Also, an employer paying an employee is subject to different requirements than when paying an independent contractor. In general, for employees it is the employer's duty to pay Social Security (FICA), the FICA excise tax, Railroad Retirement Tax Act (RRTA) withholding amounts, federal unemployment compensation (FUTA), IRS federal income tax withholdings, Medicare, and state taxes. In addition, it is the employer's responsibility to withhold a certain percentage of the employee's wages for federal income tax purposes.

On the other hand, an independent contractor must be responsible for the payment of such taxes on his or her own. The principal merely pays the fee to the contractor, and the contractor then pays the taxes at a later date, usually through four estimated payments per year. Thus, the principal is able to avoid the tax expenses and bookkeeping costs associated with such withholdings.

Benefits

When you have taken jobs in the past, were you offered a certain number of paid vacation or sick days, a retirement plan, a parking spot, a medical or dental plan? These are known as *benefits,* and they cost the employer money outside of the wages the employer must pay the employee. In an effort to attract and retain superior personnel, employers offer employees a range of benefits that generally are not required to be offered, such as dental, medical, pension, and profit-sharing plans. Independent contractors have no access to these benefits.

The Employee Retirement Income Security Act of 1974 (ERISA) was enacted to protect employee benefit plan participants from retirement plan abuses by administrators; and the Fair Labor Standards Act of 1938 (FLSA) was enacted to establish standards for minimum wages, overtime pay, employer recordkeeping, and child labor. Where a worker is considered an employee, ERISA protects the employee's benefits, while the FLSA regulates the amount of money an employee must be paid per hour and overtime compensation. A willful misclassification under FLSA may result in imprisonment and up to a $10,000 fine, imposed by the Department of Labor.

Discrimination and Affirmative Action

Can an independent contractor hold the employer liable for gender discrimination? No, Title VII and other related antidiscrimination statutes only protect *employees* from discrimination by employers. Employers are able to avoid discrimination and wrongful

discharge claims where the worker is an independent contractor. (See below for discussion on coverage of employers by various statutes.)

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

Additionally, the National Labor Relations Act protects only employees and not independent contractors from unfair labor practices. Note, however, that independent contractors may be considered to be *employers,* so they may be subject to these regulations from the other side of the fence.

Cost Reductions

It would seem to be a safe statement that an objective of most employers is to reduce cost and to increase profit. Employees are more expensive to employ, due to the above regulations that require greater expenditures on behalf of employees, as well as the fact that others must be hired to maintain records of the employees. In addition, by hiring independent contractors, the cost of overtime is eliminated (the federal wage and hour laws do not apply to independent contractors) and the employer is able to avoid any work-related expenses, such as tools, training, or traveling. The employer is also guaranteed satisfactory performance of the job for which the contractor was hired because it is the contractor's contractual obligation to adequately perform the contract with the employer, while the employee is generally able to quit without incurring liability (the at-will doctrine). If there is a breach of the agreement between the employer and the independent contractor, the independent contractor not only stands to lose the job but may also be liable for resulting damages. An employee is usually compensated for work completed with less liability for failure to perfectly perform.

vicarious liability
The imposition of liability on one party for the wrongs of another. Liability may extend from an employee to the employer on this basis if the employee is acting within the scope of her or his employment at the time the liability arose.

In addition, the employee may actually cause the employer to have greater liability exposure. An employer is **vicariously liable** if the employee causes harm to a third party while the employee is in the course of employment. For instance, if an employee is driving a company car from one company plant to another and, in the course of that trip, sideswipes another vehicle, the employer may be liable to the owner of the other vehicle. While the employee may be required to indemnify or reimburse the employer for any liability incurred as a result of the negligence, generally the third party goes after the employer because the employee does not have the funds to pay the liability. The employer could sue the employee for this reimbursement but, more likely, will write it off as an expense of doing business.

Finally, some managers contend that independent contractors are more motivated and, as a result, have a higher level of performance as a consequence of their freedom to control their own work and futures.

On the other hand, there may be situations where, notwithstanding the decrease in the amount of benefits that the employer must provide, independent contractors may still be more expensive to employ. This situation may exist where the employer finds that it is cheaper to have its employees perform certain types of work that are characteristically expensive to contract. Often a large firm will find it more profitable to employ a legal

staff, and pay their benefits and salaries, than to employ a law firm every time a legal question arises. Or a school may find it less expensive to maintain a full janitorial staff than to employ a professional cleaning crew whenever something needs to be taken care of at the school.

The Cost of Mistakes

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

In addition to potential IRS violations, the employer may be liable for violations of the National Labor Relations Act of 1935 (NLRA). Liability may include reinstatement and back pay to employees fired in violation of the NLRA under the mistaken belief that they were independent contractors. The employer may also be liable under the Fair Labor Standards Act of 1938 (FLSA) for amounts of unpaid wages or overtime compensation and for attorneys' fees and costs. Under the Employee Retirement Income Security Act of 1974 (ERISA) an employer may be liable for accrued but unpaid benefits. In addition, there is possible liability under the Social Security Act of 1935 and under state workers' compensation and unemployment compensation laws.

The fines for each violation are substantial. For example, any person who willfully violates the FLSA is subject to a fine of $10,000 and six months' imprisonment. Additionally, the tax advantages of a qualified retirement or fringe benefit plan to employers or employees may be lost as a result of misclassification.

Why is the IRS so intent on ensuring that improper classification does not occur? The IRS estimates that it loses over $2 billion a year in uncollected taxes that should have been paid by employers or the independent contractors whom they have hired. In 1989 alone, 76,000 workers were reclassified from independent contractors to employees; in some fields, misclassification rates run as high as 92 percent. As one scholar has written, IRS agents are told, "Go forth and find employees!" The IRS will generally attempt to "match" workers who claim to be independent contractors with their companies. If an independent contractor earned more than $10,000 from one source during a one-year period, the independent status of that individual is suspect.

The IRS is particularly interested in situations where a company is forced by rising costs to downsize. In doing so, many of its older workers choose to accept early retirement. Older workers, however, are often those who are more experienced and who have developed expertise in various areas of the company. Companies search for ways to use these "experts" without violating pension plan restrictions regarding recalling employees. Hiring them as independent contractors appears to be an efficient, cost-saving

mechanism. Nevertheless, the IRS has successfully challenged the employment of these workers as independent contractors where they are hired to perform services *substantially similar* to those they rendered as employees of the firm. In an analogous situation, any individual who is hired as an independent contractor to perform in a capacity substantially similar to that performed by a company's own employees will be subject to IRS challenge.

But there is hope for correct classification: the 1978 Revenue Act forms a safe harbor for employers who have consistently classified a class of workers as independent contractors. Section 530 cites four criteria required to claim a worker as an independent contractor.

First, the business must have never treated the worker as an employee for the purposes of employment taxes for any period (e.g., the company has never withheld income or FICA tax from its payments). Second, all federal tax returns with respect to this worker were filed consistent with the worker being an independent contractor. Third, the company has treated all those in positions substantially similar to that of this worker as independent contractors. And fourth, the company has a reasonable basis for treating the worker as an independent contractor. Such a reasonable basis may include a judicial precedent or published IRS ruling, a past IRS audit of the company, or long-standing industry practices, as will be discussed in greater detail later in this chapter. Where these conditions have been satisfied, the employer is not liable for misclassification.

WHO CONSTITUTES AN EMPLOYER?

Courts and regulatory agencies have not experienced great difficulty in defining the term "employer." Depending on the applicable statute or provision, an *employer* is one who employs or uses others to do his or her work, or to work on his or her behalf. Most statutes specifically include in this definition employment agencies, labor organizations, and joint labor–management committees. Issues may arise where an entity claims to be a private membership club (exempt from Title VII prohibitions) or a multinational company that may or may not be subject to application of various U.S. laws. Or, a determination must be made whether the employer receives federal funds or maintains federal contracts for coverage under the Rehabilitation Act of 1973, among others. The most exacting issue is usually how many employees an employer must have in order to be subject to a given statute. However, it is crucial for employers to be familiar with those statutes to which it is subject and those from which it is immune.

The Civil Rights Act of 1866

The Civil Rights Act (CRA) of 1866 regulates the actions of all individuals or entities that enter into a contract to employ another. An employer under the CRA of 1866 is one with 15 or more employees.

Title VII of the Civil Rights Act of 1964

Title VII applies to all firms or their agents engaged in an industry affecting commerce that employ 15 or more employees for each working day in each of 20 or more weeks in the current or preceding calendar year. Title VII exempts from its regulation

government-owned corporations, Indian tribes, and bona fide private membership clubs. "Commerce," in this context, is defined as trade, traffic, transportation, transmission, or communication among the states, between a state and any other place, within the District of Columbia, or within a possession of the United States. "Industry affecting commerce" means any activity, business, or industry in commerce or in which a labor dispute would hinder or obstruct commerce or the free flow of commerce. Lack of *intent* to affect commerce is no defense to coverage.

"Working day" is generally computed by counting the number of employees maintained on the payroll in a given week, as opposed to the number of employees who work on any one day. This calculation provides for a more expansive definition of "employer" since it includes hourly and part-time workers.[2]

Note, however, that this form of calculation is merely the majority approach; other courts have found that part-time employees who work for any part of each day of the workweek should be counted, while part-time employees who work full days for only a portion of the workweek should not be counted.

Title VI of the Civil Rights Act of 1964

Title VI applies the race, color, and national origin proscriptions of Title VII to any program or activity that receives federal financial assistance. States and state agencies are also covered under the Civil Rights Restoration Act of 1987. Title VI applies where the financial assistance to the program or activity has as its primary objective the provision of employment.

The Department of Education, one of the larger federal funding agencies, cites four categories of programs that will be covered by Title VI: projects under the Public Works Acceleration Act; work-study programs under the Vocational Education Act of 1963; programs under other funding statutes that are limited to, or in which a preference is given to, students or others training for employment; and assistance to rehabilitation facilities under the Vocational Rehabilitation Act.

Unless it falls within one of the five exemptions, a government contractor is also prohibited from discriminating on the bases of race, color, religion, gender, or national origin by Executive Order 11246. The order exempts (1) employers with contracts of less than $10,000 from the requirement to include an equal employment opportunity clause in each of their contracts; (2) contracts for work performed outside the United States by employees not recruited within the United States; (3) contracts with state and local governments by providing that the EEO requirements do not apply to any agency of that government that is not participating in the work of the contract; (4) religious educational institutions that hire only people of that religion; (5) preferences offered to Native Americans living on or near a reservation in connection with employment on or near the reservation; and (6) certain contracts on the basis of national interest or security reasons.

Age Discrimination in Employment Act of 1967

The Age Discrimination in Employment Act (ADEA) applies to all entities or their agents that employ 20 or more employees on each working day for 20 or more weeks during the current or preceding calendar year (using the same definition of "employ"

[2] *Walters* v. *Metropolitan Educational Enterprises, Inc.*, 72 FEP Cases (BNA) 1211 (1997).

as Title VII, that is, maintained on the payroll). In addition to an exemption similar to that of Title VII for government-owned corporations, the ADEA also exempts American employers who control foreign firms where compliance with the ADEA in connection with an American employee would cause the foreign firm to violate the laws of the country in which it is located. Title VII, unlike the ADEA, does *not* exempt Indian tribes or private membership clubs.

The Americans with Disabilities Act

The Americans with Disabilities Act (ADA) applies to all employers with 15 or more workers, including state and local government employers through its Title II (a), employment agencies, labor unions, and joint labor-management committees. It is similar to Title VII and computes number of employees in the same manner as described previously in regard to that act. The definition of "employer" also includes persons who are "agents" of the employer, such as managers, supervisors, foremen, or others who act for the employer, such as agencies used to conduct background checks on candidates. Executive agencies of the U.S. government are exempt from the ADA, but these agencies are covered instead by similar nondiscrimination requirements and additional affirmative employment requirements under Section 501 of the Rehabilitation Act of 1973 (see below). Also exempted from the ADA, similar to Title VII, are corporations fully owned by the U.S. government, Indian tribes, and bona fide private membership clubs that are not labor organizations and that are exempt from taxation under the Internal Revenue Code. Religious organizations are covered by the ADA, but they may give employment preference to people of their own religion or religious organization.

The Fair Labor Standards Act

The Fair Labor Standards Act (FLSA) offers coverage to workers not necessarily based on a particular definition of "employer" but on two distinct forms of coverage: "enterprise coverage" and "individual coverage." Enterprise coverage refers to the protections offered to employees who work for certain businesses or organizations (i.e., "enterprises") that have at least two employees and do at least $500,000 a year in business, or that are involved in certain specified industries such as hospitals, businesses providing medical or nursing care for residents, schools and preschools, and government agencies. Individual coverage refers to the protections offered to employees if their work regularly involves them in commerce between states ("interstate commerce"). The FLSA provides coverage, even when there is no enterprise coverage, to workers who are "engaged in commerce or in the production of goods for commerce." This coverage may include workers who produce goods that will be sent out of state, who regularly make telephone calls as part of their job to persons located in other states, or who travel to other states for their jobs. Also, domestic service workers (such as housekeepers, full-time babysitters, and cooks) are normally covered by the law. There are several exemptions based on the work that the individual conducts; those will be discussed later in this text.

Rehabilitation Act of 1973

The Rehabilitation Act provides that covered agencies may not discriminate against otherwise qualified disabled individuals, and it applies not only to all entities, programs, and activities that receive federal funds and to government contractors, but also

to all programs and activities of any executive agency as well as the U.S. Postal Service. Federal funding may include grants, loans, contracts, provision of personnel, or real or personal property. A covered federal contractor is one who maintains a contract with the federal government in excess of $10,000 annually for the provision of personal property or nonpersonal services. A contract may include any agreement between any department, agency, establishment, or instrumentality of the federal government and any person. It does not include employment contracts where the parties to the agreement are employer and employee. There is no requirement similar to that of Title VI that the assistance must be for the provision of employment.

HOW DO YOU DETERMINE WHETHER A WORKER IS AN EMPLOYEE?

Courts have offered varied interpretations of whether someone is an employee. Generally, which interpretation is used depends on the factual circumstances presented by each case, as well as which law is at issue.

A consistently cited case that illustrates the effect of the difference between classification as an independent contractor and as an employee is *Lemmerman* v. *A.T. Williams Oil Co.,* in which an eight-year-old boy frequently performed odd jobs for the Wilco Service Station at which his mother was employed. He was paid $1 a day to perform such services as stocking shelves and sweeping up. One day the boy fell and cut his hand. The boy sought damages in the form of lost wages, pain, and suffering. The main issue in this case was whether he was an employee. If he was an employee, then his sole remedy was in the form of workers' compensation; however, if he was, instead, an independent contractor, Wilco would lose the protection of the workers' compensation limits and would be liable in tort for additional amounts. Over a strong dissenting opinion, the court in *Lemmerman* determined that the boy was actually an employee of the defendant and, therefore, could not recover beyond a standard workers' compensation claim.

While many laws refer to similar definitions of "employee" or "independent contractor," other laws or regulations may rely on an entirely different test to answer the issue. Congress has responded by stating that employees are those not classified as independent contractors. The House has further explained that an employee is "one who works for another." The National Labor Relations Act states that "the term 'employee' shall not include . . . any individual having the status of an independent contractor" but does not define independent contractor.

Several tests have been developed and are commonly used by courts to classify employees and independent contractors. These tests include the common-law test of agency, which focuses on the right of control, the Internal Revenue Service (IRS) 20-factor analysis, and the economic realities analysis. Several courts also use a hybrid approach, using one test that combines factors from other tests.

Under the **common-law agency test**, a persuasive indicator of independent-contractor status is the ability to control the manner in which the work is performed. This test was derived from the law involving domestic relations of the "master and servant." Where the master had control over the servant, the worker was considered the master's servant, employed by and connected to that master, more similar to common-law

property rights than contract rights. Today, the contract or agency principles apply rather than property principles. The element of control has persisted in today's interpretation of who constitutes an employee and who is an independent contractor. The right to control remains the predominant factor.

Under the common-law agency approach, the employer need not actually control the work, but must merely *have the right or ability* to control the work for a worker to be classified an employee. Although this is a strong indication that the worker is an employee, other factors usually are considered. For example, it has been held that an employee is one who works for wages or salary and is under direct supervision. An independent contractor has benefited as one who does a "job for a price, decides how the work will be done, usually hires others to do the work, and depends for their income not upon wages, but upon the difference between what they pay for goods, materials and labor and what they receive for the end result, that is upon profits."

The common-law test is specifically and consistently used to determine employee status in connection with FUTA and FICA taxes, in determining whether an employee is a statutory employee (discussed later in this chapter), as well as in federal income tax withholding.

IRS test
List of 20 factors to which the IRS looks to determine whether someone is an employee or an independent contractor. The IRS compiled this list from the results of judgments of the courts relating to this issue.

Under the **IRS 20-factor analysis**, the IRS, in training material issued in July 1996, explained that "this Twenty Factor Test is an analytical tool and *not* the legal test used for determining worker status. The legal test is whether there is a right to direct and control the means and details of the work" (emphasis in original).[3]

EEOC guidance on application of EEO laws to contingent workers provides similar guidelines for determining whether working conditions are controlled by the business, thus placing the worker within the protection of the federal antidiscrimination statutes. However, the following 20 factors have been consistently and continually articulated by courts, regulatory agencies, commentators, and scholars as critical to the determination of the status of an individual worker. When these factors are satisfied, courts are more likely to find "employee" status. In addition, the IRS stated that these 20 factors are not inclusive but that "every piece of information that helps determine the extent to which the business retains the right to control the worker is important." (See Exhibit 1.3.)

1. *Instructions.* A worker who is required to comply with other persons' instructions about when, where, and how to perform the work is ordinarily considered to be an employee.
2. *Training.* Training a worker indicates that the employer exercises control over the means by which the result is accomplished.
3. *Integration.* When the success or continuation of a business depends on the performance of certain services, the worker performing those services is subject to a certain amount of control by the owner of the business.
4. *Services rendered personally.* If the services must be rendered personally, the employer controls both the means and the results of the work.
5. *Hiring, supervising, and paying assistants.* Control is exercised if the employer hires, supervises, and pays assistants.

[3] Department of Treasury, Internal Revenue Service, "Employee or Independent Contractor?" Training 3320-102 (July 1996).

Exhibit 1.3 Employee or Independent Contractor?

The IRS, in its training materials, offers this case study on the question of whether someone is an employee or an independent contractor:

A computer programmer is laid off when company X downsizes. Company X agrees to pay the programmer $10,000 to complete a one-time project to create a certain product. It is not clear how long it will take to complete the project, and the programmer is not guaranteed any minimum payment for the hours spent on the project. The programmer does the work on a new high-end computer, which was purchased by the company. The programmer works at home, but may attend meetings of the software development group at the firm. Company X provides the programmer with no instructions beyond the specifications for the product itself. The programmer and company X have a written contract, which provides that the programmer is considered to be an independent contractor, is required to pay her own taxes, and receives no benefits from company X.

Is she an employee?

Source: Internal Revenue Service; case modified slightly by the author.

6. *Continuing relationships.* The existence of a continuing relationship between the worker and the employer indicates an employer–employee relationship.
7. *Set hours of work.* The establishment of hours of work by the employer indicates control.
8. *Full time required.* If the worker must devote full time to the employer's business, the employer has control over the worker's time. An independent contractor is free to work when and for whom she or he chooses.
9. *Doing work on the employer's premises.* Control is indicated if the work is performed on the employer's premises.
10. *Order or sequence set.* Control is indicated if a worker is not free to choose his or her own pattern of work but must perform services in the sequence set by the employer.
11. *Oral or written reports.* Control is indicated if the worker must submit regular oral or written reports to the employer.
12. *Furnishing tools and materials.* If the employer furnishes significant tools, materials, and other equipment, an employer–employee relationship usually exists.
13. *Payment by hour, week, or month.* Payment by the hour, week, or month points to an employer–employee relationship, provided that this method of payment is just not a convenient way of paying a lump sum agreed on as a cost of a job. However, hourly pay may not be evidence that a worker is an employee if it is customary to pay an independent contractor by the hour (an attorney, for example). An independent contractor usually is paid by the job or on a straight commission.
14. *Payment of business or traveling expenses.* Payment of the worker's business or traveling expenses, or both, is indicative of an employer–employee relationship. However, this factor is less important because companies do reimburse independent contractors.
15. *Significant investment.* A worker is an independent contractor if she or he invests in facilities that are not typically maintained by employees, such as the maintenance of an office rented at fair value from an unrelated party. An employee depends on the employer for such facilities.

16. *Realization of profit or loss.* A worker who can realize a profit or loss (in addition to the profit or loss ordinarily realized by employees) through management of resources is an independent contractor. The worker who cannot is generally an employee.
17. *Working for more than one firm at a time.* If a worker performs more than *de minimis* services for a number of unrelated persons at the same time, she or he is usually considered an independent contractor.
18. *Making service available to the general public.* A worker is usually an independent contractor if the services are made available to the general public on a regular or consistent basis.
19. *Right to discharge.* The right of the employer to discharge a worker indicates that he or she is an employee.
20. *Right to terminate.* A worker is an employee if the right to end the relationship with the principal is available at any time he or she wishes without incurring liability.

In addition to the basic analysis under the IRS test, attorney Christina Morfeld provides the following helpful analysis to consider when determining whether an individual is more appropriately classified as an employee or independent contractor (IC) (see also Exhibit 1.4):

	Yes	**No**
1. Is the individual's work vital to the company's core business?	**Employee** activities are integrated with the organization's business operations.	**IC** services are typically limited to nonessential business activities.
2. Did you train the individual to perform tasks in a specific way? 3. Do you (or can you) instruct the individual as to when, where, and how the work is performed? 4. Do you (or can you) control the sequence or order the work performed?	**Employees** are usually taught the specific work procedures that they are expected to follow and must comply with any other employer requirements with regard to these activities.	**ICs** are generally considered "experts" in their field and, as such, can determine which work methods are most appropriate. Additionally, they are typically held accountable only for outcomes, not the means with which they are achieved.
5. Do you (or can you) set the hours of work for the individual?	**Employees** generally work on a schedule determined by their employer.	**ICs** can work whatever hours they choose, provided that agreed-upon deadlines are met.
6. Do you (or can you) require the individual to perform the work personally? 7. Do you (or can you) prohibit the individual from hiring, supervising, and paying assistants?	**Employees** must do the tasks for which they were hired themselves.	**ICs** are free to delegate to their own staff or subcontract the work to others.

8. Does the individual perform regular and continuous services for you?	**Employees** typically have an open-ended relationship with a company, even if the work is performed at irregular intervals.	**ICs** work on a project-by-project basis, each time with a new contract.
9. Does the individual provide services on a substantially full-time basis to your company? 10. Is your company the sole o major source of income for the individual?	**Employees** are usually expected to devote all working hours to their employer.	**ICs** do not spend so much time with any one company that they are restricted from doing projects for others and, in fact, generally work for multiple clients concurrently.
11. Is the work performed on your premises?	**Employees** are ordinarily required to work on-site.	**ICs** are free to work off-site, such as in a home office.
12. Do you (or can you) require the individual to submit regular reports, either written or oral?	**Employees** may be asked to provide status or activity reports on a regular basis.	**ICs** are responsible for producing a final deliverable and are not, therefore, required to provide interim reports.
13. Do you pay the individual by the hour, week, or month?	**Employees** are usually paid at fixed intervals.	**ICs** are generally paid for their results, not the amount of time worked.
14. Do you pay the individual's travel and business expenses?	**Employees** who incur work-related expenses are typically reimbursed by their employer.	**ICs** are usually expected to incorporate out-of-pocket expenses into their project fee rather than be directly reimbursed for them.
15. Do you furnish tools or equipment for the individual?	**Employees** generally use company provided supplies.	**ICs** are expected to own and use their own supplies.
16. Does the individual have a significant investment in facilities, tools, or equipment?	**ICs** incur expenses related to work space, equipment, etc., like any other business owner.	**Employees** typically use their company's facilities, tools and equipment.
17. Can the individual realize a profit or loss from his or her services to your company?	**ICs** run the risk of nonpayment if a project is not completed according to the specifications detailed in the contract.	**Employees** can usually expect steady paychecks.
18. Does the individual make his or her services available to the general public?	**ICs** publicize their services to a wide range of potential clients via direct mail, advertising, etc.	**Employees** do not typically position and market themselves as services providers.
19. Can the individual terminate the relationship without liability? 20. Do you have the right to discharge the individual at any time?	**Employees** can quit at any time and can typically be released "at will" by their employers.	**ICs** are legally obligated to complete projects according to contract provisions and can only be dismissed if they fail to do so.

Reprinted from Christina Morfeld, "Employee vs. Independent Contractor: A Game of 20 Questions," http://affinitybizcomm.com/EEvsIC.htm, with permission of the author, Christina Morfeld.

Finally, under the *economic realities test,* courts consider whether the worker is economically dependent on the business or, as a matter of economic fact, is in business for himself or herself. In applying the economic realities test, courts look to the degree of control exerted by the alleged employer over the worker, the worker's opportunity for profit or loss, the worker's investment in the business, the permanence of the working relationship, the degree of skill required by the worker, and the extent the work is an integral part of the alleged employer's business. Typically, all of these factors are considered as a whole with none of the factors being determinative.

In the following case, the point at issue concerned whether four physicians in a medical practice could be counted as "employees" of the practice. The Supreme Court applied the common-law standard of control found in the Restatement (Second) of Agency and Equal Employment Opportunity Commission (EEOC) guidelines, whereas the District Court originally relied on the economic realities test. The workers believed they were employees rather than independent contractors and thus entitled to overtime compensation. The court used the economic realities test in determining the classification of the workers.

Clackamas Gastroenterology Associates, P. C. v. Wells,
123 S.Ct. 1673 (2003)

Wells sued Clackamas, a medical clinic, alleging disability discrimination in violation of the Americans with Disabilities Act (ADA). However, since the Americans with Disabilities Act of 1990 (ADA) only applies to businesses whose workforce included "15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year," a question arose as to whether four physicians actively engaged in medical practice as shareholders and directors of a professional corporation should be counted as "employees." The United States District Court for the District of Oregon granted the clinic's motion for summary judgment and Wells appealed. The Ninth Circuit reversed and remanded.

Stevens, J.

Petitioner, Clackamas Gastroenterology Associates, P. C., is a medical clinic in Oregon. It employed respondent, Deborah Anne Wells, as a bookkeeper from 1986 until 1997. After her termination, she brought this action against the clinic alleging unlawful discrimination on the basis of disability under the ADA. Petitioner denied that it was covered by the Act and moved for summary judgment, asserting that it did not have 15 or more employees for the 20 weeks required by the statute. It is undisputed that the accuracy of that assertion depends on whether the four physician–shareholders who own the professional corporation and constitute its board of directors are counted as employees.

The District Court . . . granted the motion. Relying on an "economic realities" test adopted by the Seventh Circuit in *EEOC* v. *Dowd & Dowd, Ltd.,* the District Court concluded that the four doctors were "more analogous to partners in a partnership than to shareholders in a general corporation" and therefore were "not employees for purposes of the federal antidiscrimination laws."

A divided panel of the Court of Appeals for the Ninth Circuit reversed. Noting that the Second Circuit had rejected the economic realities approach, the majority held that the use of any corporation, including a professional corporation, "precludes any examination designed to determine whether the entity is in fact a partnership." It saw "no reason to permit a professional corporation to secure the 'best of both possible worlds' by allowing it both to assert its corporate status in order

to reap the tax and civil liability advantages and to argue that it is like a partnership in order to avoid liability for unlawful employment discrimination." The dissenting judge stressed the differences between an Oregon physicians' professional corporation and an ordinary business corporation, and argued that Congress' reasons for exempting small employers from the coverage of the Act should apply to petitioner.

We granted certiorari to resolve the conflict in the Circuits, which extends beyond the Seventh and the Second Circuits.

II

"We have often been asked to construe the meaning of 'employee' where the statute containing the term does not helpfully define it." *Nationwide Mut. Ins. Co.* v. *Darden*. The definition of the term in the ADA simply states that an "employee" is "an individual employed by an employer." That surely qualifies as a mere "nominal definition" that is "completely circular and explains nothing." As we explained in Darden, our cases construing similar language give us guidance on how best to fill the gap in the statutory text.

* * *

Rather than looking to the common law, petitioner argues that courts should determine whether a shareholder–director of a professional corporation is an "employee" by asking whether the shareholder–director is, in reality, a "partner." . . . The question whether a shareholder–director is an employee, however, cannot be answered by asking whether the shareholder–director appears to be the functional equivalent of a partner. Today there are partnerships that include hundreds of members, some of whom may well qualify as "employees" because control is concentrated in a small number of managing partners. Thus, asking whether shareholder–directors are partners—rather than asking whether they are employees—simply begs the question.

Nor does the approach adopted by the Court of Appeals in this case fare any better. The majority's approach, which paid particular attention to "the broad purpose of the ADA," is consistent with the statutory purpose of ridding the Nation of the evil of discrimination. Nevertheless, two countervailing considerations must be weighed in the balance. First, as the dissenting judge noted below, the congressional decision to limit the coverage of the legislation to firms with 15 or more employees has its own justification that must be respected—namely, easing entry into the market and preserving the competitive position of smaller firms. Second, as *Darden* reminds us, congressional silence often reflects an expectation that courts will look to the common law to fill gaps in statutory text, particularly when an undefined term has a settled meaning at common law. Congress has overridden judicial decisions that went beyond the common law in an effort to correct "the mischief" at which a statute was aimed.

. . . The common law's definition of the master–servant relationship does provide helpful guidance. At common law the relevant factors defining the master–servant relationship focus on the master's control over the servant. The general definition of the term "servant" in the Restatement (Second) of Agency, for example, refers to a person whose work is "controlled or is subject to the right to control by the master." In addition, the Restatement's more specific definition of the term "servant" lists factors to be considered when distinguishing between servants and independent contractors, the first of which is "the extent of control" that one may exercise over the details of the work of the other. We think that the common-law element of control is the principal guidepost that should be followed in this case.

This is the position that is advocated by the Equal Employment Opportunity Commission (EEOC), the agency that has special enforcement responsibilities under the ADA and other federal statutes containing similar threshold issues for determining coverage. It argues that a court should examine "whether shareholder–directors operate independently and manage the business or instead are subject to the firm's control." According to the EEOC's view, "[i]f the shareholder–directors operate independently and manage the business, they are proprietors and not employees; if they are subject to the firm's control, they are employees."

Specific EEOC guidelines discuss both the broad question of who is an "employee" and the narrower question of when partners, officers, members of boards of directors, and major shareholders qualify as employees. With respect to the broad question, the guidelines list 16 factors—taken from *Darden*—that may be relevant to "whether the employer controls the means and manner of the worker's work performance." The guidelines list six factors to be considered in answering the narrower question, which they frame as "whether the individual acts independently and participates in managing the organization, or whether the individual is subject to the organization's control."

We are persuaded by the EEOC's focus on the common-law touchstone of control and specifically by its submission that each of the following six factors is

relevant to the inquiry whether a shareholder–director is an employee:

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

As the EEOC's standard reflects, an employer is the person, or group of persons, who owns and manages the enterprise. The employer can hire and fire employees, can assign tasks to employees and supervise their performance, and can decide how the profits and losses of the business are to be distributed. The mere fact that a person has a particular title—such as partner, director, or vice president—should not necessarily be used to determine whether he or she is an employee or a proprietor. Nor should the mere existence of a document styled "employment agreement" lead inexorably to the conclusion that either party is an employee. Rather, as was true in applying common law rules to the independent-contractor-versus-employee issue confronted in *Darden,* the answer to whether a shareholder–director is an employee depends on "'all of the incidents of the relationship . . . with no one factor being decisive.'"

III

Some of the District Court's findings—when considered in light of the EEOC's standard—appear to weigh in favor of a conclusion that the four director–shareholder physicians in this case are not employees of the clinic. For example, they apparently control the operation of their clinic, they share the profits, and they are personally liable for malpractice claims. There may, however, be evidence in the record that would contradict those findings or support a contrary conclusion under the EEOC's standard that we endorse today. Accordingly, as we did in Darden, we reverse the judgment of the Court of Appeals and remand the case to that court for further proceedings consistent with this opinion.

It is so ordered.

Justice GINSBURG, with whom Justice BREYER joins, dissenting.

"There is nothing inherently inconsistent between the coexistence of a proprietary and an employment relationship." As doctors performing the everyday work of petitioner Clackamas Gastroenterology Associates, P. C., the physician–shareholders function in several respects as common-law employees, a designation they embrace for various purposes under federal and state law. Classifying as employees all doctors daily engaged as caregivers on Clackamas' premises, moreover, serves the animating purpose of the Americans with Disabilities Act of 1990 (ADA or Act). Seeing no cause to shelter Clackamas from the governance of the ADA, I would affirm the judgment of the Court of Appeals.

An "employee," the ADA provides, is "an individual employed by an employer." Where, as here, a federal statute uses the word "employee" without explaining the term's intended scope, we ordinarily presume "Congress intended to describe the conventional master–servant relationship as understood by common-law agency doctrine." The Court today selects one of the common-law indicia of a master–servant relationship—control over the work of others engaged in the business of the enterprise—and accords that factor overriding significance. I would not so shrink the inquiry.

Are the physician–shareholders "servants" of Clackamas for the purpose relevant here? The Restatement defines "servant" to mean "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." When acting as clinic doctors, the physician–shareholders appear to fit the Restatement definition. The doctors provide services on behalf of the corporation, in whose name the practice is conducted. The doctors have employment contracts with Clackamas under which they receive salaries and yearly bonuses, and they work at facilities owned or leased by the corporation. In performing their duties, the doctors must "compl[y] with . . . standards [the organization has] established."

The physician–shareholders, it bears emphasis, invite the designation "employee" for various purposes under federal and state law. The Employee Retirement Income Security Act of 1974 (ERISA), much like the ADA, defines "employee" as "any individual employed by an employer." Clackamas readily acknowledges that the physician–shareholders are "employees" for ERISA purposes. Indeed, gaining qualification as "employees"

under ERISA was the prime reason the physician–shareholders chose the corporate form instead of a partnership. Further, Clackamas agrees, the physician–shareholders are covered by Oregon's workers' compensation law, a statute applicable to "person[s] . . . who . . . furnish services for a remuneration, subject to the direction and control of an employer." Finally, by electing to organize their practice as a corporation, the physician–shareholders created an entity separate and distinct from themselves, one that would afford them limited liability for the debts of the enterprise. I see no reason to allow the doctors to escape from their choice of corporate form when the question becomes whether they are employees for purposes of federal antidiscrimination statutes.

Nothing in or about the ADA counsels otherwise. As the Court observes, the reason for exempting businesses with fewer than 15 employees from the Act, was "to spare very small firms from the potentially crushing expense of mastering the intricacies of the antidiscrimination laws, establishing procedures to assure compliance, and defending against suits when efforts at compliance fail." The inquiry the Court endorses to determine the physician–shareholders' qualification as employees asks whether they "ac[t] independently and participat[e] in managing the organization, or . . . [are] subject to the organization's control." Under the Court's approach, a firm's coverage by the ADA might sometimes turn on variations in ownership structure unrelated to the magnitude of the company's business or its capacity for complying with federal prescriptions.

This case is illustrative. In 1996, Clackamas had 4 physician–shareholders and at least 14 other employees for 28 full weeks; in 1997, it had 4 physician–shareholders and at least 14 other employees for 37 full weeks. Beyond question, the corporation would have been covered by the ADA had one of the physician–shareholders sold his stake in the business and become a "mere" employee. Yet such a change in ownership arrangements would not alter the magnitude of Clackamas' operation: In both circumstances, the corporation would have had at least 18 people on site doing the everyday work of the clinic for the requisite number of weeks.

The Equal Employment Opportunity Commission's approach, which the Court endorses, it is true, "excludes from protection those who are most able to control the firm's practices and who, as a consequence, are least vulnerable to the discriminatory treatment prohibited by the Act." As this dispute demonstrates, however, the determination whether the physician–shareholders are employees of Clackamas affects not only whether they may sue under the ADA, but also—and of far greater practical import—whether employees like bookkeeper Deborah Anne Wells are covered by the Act. Because the character of the relationship between Clackamas and the doctors supplies no justification for withholding from clerical worker Wells federal protection against discrimination in the workplace, I would affirm the judgment of the Court of Appeals.

Case Questions

1. Are you more persuaded by the District Court's analysis (applying the economic realities test), the ninth Circuit's analysis (reviewing the distinction between a corporation and a partnership), or the Supreme Court's analysis (relying on the common-law element of control)?
2. Do you believe that *Clackamas* will make it easier or more difficult to classify individuals as employees? No matter what your answer to this above question, do you believe the *Clackamas* decision will lead to the fairest results?
3. Are you persuaded more by the majority or dissent? Is it relevant to your decision that the physicians are classified as employees under another act (ERISA)? Which answer best seems to serve the objectives of the ADA?

Contingent or Temporary Workers

A *contingent worker* is one whose job with an employer is temporary, is sporadic, or differs in any way from the norm of full-time employment. As used by the EEOC, the term "contingent worker" includes those who are hired by an employer through a staffing firm, as well as temporary, seasonal, and part-time workers, and those considered to be independent contractors rather than employees.[4] (See Exhibit 1.5.)

[4] See "EEOC Enforcement Guidance on Application of EEO Laws to Contingent Workers Placed by Temporary Employment Agencies and Other Staffing Firms," *EEOC Enforcement Guidance,* December 1997.

Exhibit 1.4 Internal Revenue Service "Independent Contractor or Employee?" Publication 1779

Independent Contractor or Employee

Which are you?

For federal tax purposes, this is an important distinction. Worker classification affects how you pay your federal income tax, social security and Medicare taxes, and how you file your tax return. Classification affects your eligibility for employer and social security and Medicare benefits and your tax responsibilities. If you aren't sure of your work status, you should find out now. This brochure can help you.

The courts have considered many facts in deciding whether a worker is an **independent contractor** or an **employee**. These relevant facts fall into three main categories: *behavioral control; financial control;* and *relationship of the parties*. In each case, it is very important to consider all the facts – no single fact provides the answer. Carefully review the following definitions.

Behavioral Control

These facts show whether there is a right to direct or control how the worker does the work. A worker is an employee when the business has the right to direct and control the worker. The business does not have to actually direct or control the way the work is done – as long as the employer has the right to direct and control the work. For example:

- **Instructions** – if you receive extensive instructions on how work is to be done, this suggests that you are an **employee**. Instructions can cover a wide range of topics, for example:
  - how, when, or where to do the work
  - what tools or equipment to use
  - what assistants to hire to help with the work
  - where to purchase supplies and services

  If you receive less extensive instructions about what should be done, but not how it should be done, you may be an **independent contractor**. For instance, instructions about time and place may be less important than directions on how the work is performed.

- **Training** – if the business provides you with training about required procedures and methods, this indicates that the business wants the work done in a certain way, and this suggests that you may be an **employee**.

Financial Control

These facts show whether there is a right to direct or control the business part of the work. For example:

- **Significant Investment** – if you have a significant investment in your work, you may be an **independent contractor**. While there is no precise dollar test, the investment must have substance. However, a significant investment is not necessary to be an **independent contractor**.
- **Expenses** – if you are not reimbursed for some or all business expenses, then you may be an **independent contractor**, especially if your unreimbursed business expenses are high.
- **Opportunity for Profit or Loss** – if you can realize a profit or incur a loss, this suggests that you are in business for yourself and that you may be an **independent contractor**.

Relationship of the Parties

These are facts that illustrate how the business and the worker perceive their relationship. For example:

- **Employee Benefits** – if you receive benefits, such as insurance, pension, or paid leave, this is an indication that you may be an **employee**. If you do not receive benefits, however, you could be either an **employee** or an **independent contractor**.
- **Written Contracts** – a written contract may show what both you and the business intend. This may be very significant if it is difficult, if not impossible, to determine status based on other facts.

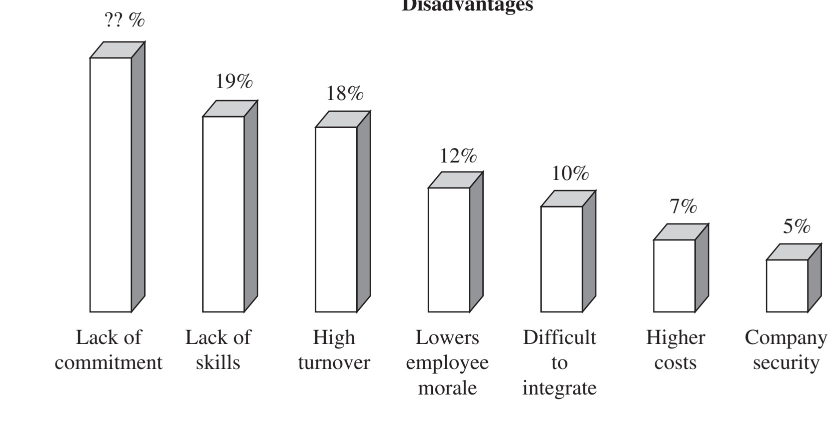
When You Are an *Employee*

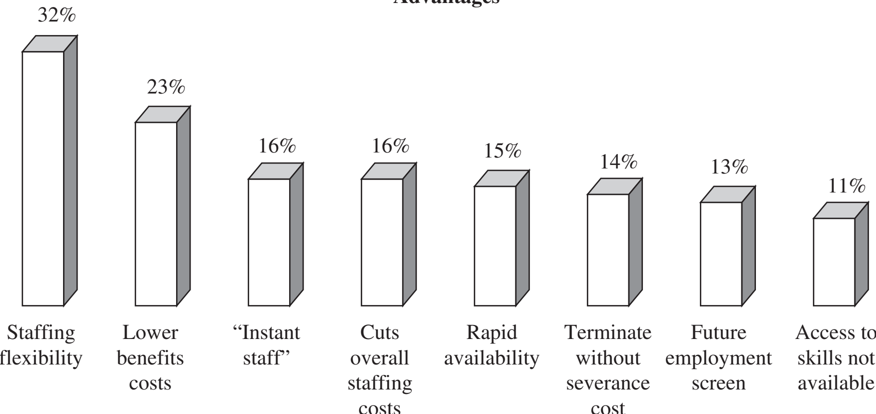
- Your employer must withhold income tax and your portion of social security and Medicare taxes. Also, your employer is responsible for paying social security, Medicare, and unemployment (FUTA) taxes on your wages. Your employer must give you a Form W-2, *Wage and Tax Statement*, showing the amount of taxes withheld from your pay.
- You may deduct unreimbursed employee business expenses on Schedule A of your income tax return, but only if you itemize deductions and they total more than two percent of your adjusted gross income.

When You Are an *Independent Contractor*

- The business may be required to give you Form 1099-MISC, *Miscellaneous Income*, to report what it has paid to you.
- You are responsible for paying your own income tax and self-employment tax (Self-Employment Contributions Act – SECA). The business does not withhold taxes from your pay. You may need to make estimated tax payments during the year to cover your tax liabilities.
- You may deduct business expenses on Schedule C of your income tax return.

Source: Internal Revenue Service Publication 1779 (Rev. 12-99), Catalog No. 16134L.





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When utilizing contingent and temporary workers, an employer must be cognizant of the advantages and disadvantages. (See Exhibit 1.5.) Although contingent or temporary workers provide a cost savings as a short-term benefit, depending on their classification they could be entitled to protection under the employment laws. It is important to be sure the classification given is the true classification.

The Joint Employer

Whether a contingent worker who is placed by a staffing firm with the firm's clients is an employee depends on a number of factors, including whether the staffing firm or the client retains the right to control when, where, and how the worker performs the job and whether there is a continuing relationship with the worker, among other factors. What is unique about the worker placed by a staffing firm is the potential for joint liability between the staffing firm and the client.

Similarly, in a case that sought to determine liability for wage and hour violations, the Second Circuit Court of Appeals considered whether the right to control is necessary to create liability based on joint employment. In *Zheng* v. *Liberty Apparel Co.,* 355 F.3d 61 (2d Cir. 2003), Liberty was a clothing manufacturer that subcontracted with a garment factory to produce its clothing. In finding liability based on the joint employer concept, the court held that all relevant factors should be considered including (but not limited to):

1. Whether the manufacturer/contractor employer's premises and equipment were used for the subcontractor's work.
2. Whether the subcontractor had a business that could or did shift as a unit from one putative joint employer to another.
3. The extent to which the subcontractor performed a discrete line-job that was integral to the contractor's process of production.
4. Whether responsibility under the contracts could pass from one subcontractor to another without material change.
5. The degree to which the contractors or their agents supervised the subcontractor's work.
6. Whether the subcontractors worked exclusively or predominantly for the contractors.[5]

The court specifically warned that not all outsourcing relationships would be classified as "joint employers," only those that "lack a substantial economic purpose, but it is manifestly not intended to bring normal, strategically oriented contracting schemes within the ambit of the FLSA."

Title VII prohibits staffing firms from illegally discriminating against workers in assignments and opportunities for employment. Staffing firms may qualify as the employer of the placed worker, as well. For example, if the staffing firm pays the worker and provides training and workers' compensation coverage, it may create an employment relationship with the worker.

If a client of a staffing firm supervises, trains, and otherwise directs the worker with whom it has a continuing relationship, then perhaps the client will become an employer of the worker. Could both the staffing firm and the client be considered the worker's employer? The answer is yes: The staffing firm and client may share liability as employers of the worker.

This raises concerns regarding liability under wage and hour laws, workers' compensation, and federal antidiscrimination statutes such as Title VII. Federal courts have recognized "joint and several" liability between staffing firm and client. The worker may collect compensatory damages from either one or both of the entities combined.

Further, employers may be held liable as "third-party interferers" under Title VII. For example, if an employer decides to ask its staffing firm to replace the temporary receptionist with one of another race, the receptionist could proceed with a Title VII claim against the employer because it improperly interfered with her employment opportunities with the staffing firm. Therefore, an employer using a staffing firm cannot avoid liability for discriminating against a temporary worker merely because it did not "employ" the worker.

[5] Ibid. at 72.

Defining "Applicant"

Since federal regulations often require employers to track applicants on the basis of race, gender, and ethnicity, it is important to have a clear and consistent definition of who is an "applicant." Moreover, in this electronic age, technology has altered the way that people apply for jobs. As a result, the Uniform Guidelines on Employee Selection Procedures were modified to include the following, expanded definition of applicant in the context of the Internet and related electronic data processing technologies: An "applicant" exists when three conditions have been met:

1. The employer has acted to fill a particular position.
2. The individual has followed the employer's standard procedures for submitting applications.
3. The individual has indicated an interest in the particular position. Where the applicant is instead a traditional job seeker, the original definition still applies—an applicant is someone who has "indicated an interest in being considered" for employment. The impact of this change is that an e-mail inquiry about a job does not qualify the sender as an applicant, nor does the posting of a résumé on a third party job board.

BACKGROUND—THE EMPLOYMENT-AT-WILL DOCTRINE

at-will employment
An employment relationship where there is no contractual obligation to remain in the relationship; either party may terminate the relationship at any time, for any reason, as long as the reason is not prohibited by law, such as for discriminatory purposes.

Initially, the theoretical underpinnings of the American employer–employee relationship was one based on the English feudal system. When employers were the wealthy landowners who owned the land on which "serfs" (workers) toiled, employers supplied virtually all the workers' needs, took care of disputes that arose, and allowed the workers to live out their lives on the land after they could no longer be the productive serfs they once were. The employer took care of the employees as parents would their children.

When we moved from an agrarian society toward a more industrialized one, the employee–employer relationship became further removed than before, but the underlying theory was still maintained: The employee could work for the employer as long as the employee wished, and leave when the employee no longer wished to work for the employer (therefore, the employees worked at their own will). The reverse was also true: The employer employed the employee for as long as the employer wished, and, when the employer no longer wished to have the employee in his or her employ, the employee had to leave.

Both parties were free to leave at virtually any time for any reason. Of course, if there was a contract between the parties, either as a collective bargaining agreement or an individual contract, the relationship was not governed by the will of the parties, but rather by the contract. Further, government employees generally were not considered at-will employees: Limitations were imposed on the government employer through rules governing the terms and termination of the federal employment relationship.

When "equal employment opportunity" legislation entered the equation, the employer's rights to hire and fire were circumscribed to a great extent. While an employer was free to terminate an employee for no particular reason, it could not terminate a worker based on race, gender, religion, national origin, age, or disability. Providing protection for members of historically discriminated-against groups through such laws as Title VII, the Age Discrimination in Employment Act, and the Americans with

Disabilities Act also had the predictable effect of making all employees feel more empowered in their employment relationships. While virtually no employees sued employers before such legislation, subsequently employees were willing to challenge employers' decisions in legal actions.

With women, minorities, older employees, disabled employees, and veterans given protected status under the laws, it was not long before those who were not afforded specific protection began to sue employers, based on their perception that it "just wasn't right" for an employer to be able to terminate them for any reason of the employer, regardless of whether the reason was in violation of antidiscrimination statutes. To them it was beside the point that they did not fit neatly into a protected category. They had been "wronged" and they wanted their just due. An employee could be fired if the employer didn't like the employee's green socks, or the way the employee wore his hair, or because the employee "blew it" on attempting to get his first account after being hired. There was no recourse because, since the relationship was at will, the employer could fire the employee for whatever reason the employer wished, as long as it was not a violation of the law.

Visualize a whole luscious, delectable pie of your favorite type. That pie represents the employer's rights in the workplace. At first, virtually the whole pie belonged to the employer. The employer could do practically anything the employer wished to do regarding the right to hire, fire, pay, or legislate employee activities in the workplace. Then Congress began passing laws that limited in some way the employer's prerogatives. The pie gets smaller and smaller as more and more of the pie is "eaten away" by laws. There are both state and federal laws governing wages and hours, child labor laws, equal employment laws, equal pay laws—all of which govern such areas as wages the employer will pay, time limits on how long employees can work, limits on the age employees must be, and prohibitions on reasons the employer can refuse to hire or terminate or discipline employees. If an employer was unionized, there was even less pie left. Employers who had their mouths set on having the whole pie ended up with much less than they envisioned. Then along comes the weakening of the employment-at-will concept, and much of the pie the employer thought was left is taken away. The amount of pie left to the employer is enough to be a filling portion, but much less than the employer initially thought he or she would have for disposal.

Regardless of whether a terminated employee is a member of a group protected from discrimination, the employee may bring suit on the basis of unjust dismissal or wrongful termination. The employee believes that there is an unjust reason for his or her dismissal and brings suit against the employer, seeking reinstatement or compensatory and punitive damages for the losses suffered in being unjustly dismissed.

Unjust dismissal cases have been brought alleging termination for signing a union card, filing workers' compensation claims, refusing to assist the employer in committing a crime, refusing to commit a crime on the employer's behalf, refusing to forgo suit against the employer for a valid legal claim against the employer, refusal to avoid jury duty, refusal to falsify records, refusal to lie in testifying in a case involving the employer, reporting wrongdoing or illegal activity by the employer, and termination at a time when the employee was about to receive a substantial bonus from the employer.

Probably because the law also began to recognize certain basic rights in its concept of the employment relationship, and because of the basic unfairness involved in some of the cases that the courts were asked to decide, courts all over the country began making exceptions to the at-will doctrine. The at-will doctrine is developed on a state-by-state

basis because each state is free to make law governing the at-will doctrine. Therefore, the changes in the at-will doctrine vary from state to state. Congress has entertained proposals to deal with the at-will doctrine on the federal level, but, as of yet, none has been successful. In August 1991, the Commission on Uniform State Laws issued a model termination act that states may use. The intent is to make terminations so uniform across the country that there will be some predictability and consistency where now there is only a patchwork of laws and case law. This model act, and its status, will be discussed later in the chapter.

The state-by-state approach to addressing the exceptions to the at-will doctrine has created a crazy quilt of laws across the country. In some states the at-will doctrine has virtually no exceptions and, therefore, remains virtually intact as it always was. In other states the courts have created judicial exceptions to the at-will doctrine that apply in certain limited circumstances. In still other states, the state legislature has passed laws providing legislative exceptions to the at-will doctrine.

EXCEPTIONS TO THE AT-WILL DOCTRINE

Employment at will is still the basic law in many states. However, the employment-at-will doctrine several years ago began to erode. There have been several judicial exceptions to the rule created by courts. The result is that, even though an employer can terminate an employee for any legal reason, if the reason is one that is determined to fall within an exception to the at-will doctrine, the employee can assert a claim for wrongful termination or discharge, for which the employee can receive damages or reinstatement.

Though difficult cases for employees to prove, courts and state legislation have been fairly consistent in holding that exceptions will be permitted where the employer breaches an implied covenant of good faith and fair dealing, where an implied promise to the employee was breached, or where breach of an implied contract with the employee or the discharge is in violation of some recognized public policy. Keep in mind that if the employee and employer have an individual contract or a collective bargaining agreement, then the employment relationship is governed by the agreement. If the employer is the government, then the employment relationship regarding dismissals is governed by appropriate government regulations. It is the other 65 percent of the workforce that is covered by the employment-at-will doctrine.

The Worker Adjustment and Retraining Notification Act

The Worker Adjustment and Retraining Notification (WARN) Act generally requires that 60 days' advance notice of a "plant closing" or "mass layoff" be given to affected employees. A plant closing triggers a notice requirement if it would result in employment loss for 50 or more workers during a 30-day period. "Mass layoff" is defined as employment losses at one location during any 30-day period of 500 or more workers, or of 50–499 workers if they comprise at least one-third of the active workforce. Employees who have worked less than 6 months of the prior 12 or who work less than 20 hours a week are excluded from both computations. If an employer does not comply with the requirements of the WARN Act notices, employees can recover pay and benefits for the period for which notice was not given, up to a maximum of 60 days. All but small employers and public employers are required to provide written notice of a "plant closing" or "mass layoff" no less than 60 days in advance.

Exceptions to the Doctrine of Employment-at-Will

States vary in terms of their recognition of the following exceptions to the doctrine of employment-at-will. Some states recognize one or more exceptions while others might recognize none at all. In addition, the definition of these exceptions may also vary from state to state.

- Bad faith, malicious or retaliatory termination in violation of ***public policy***.
- Termination in breach of the ***implied covenant of good faith and fair dealing***.
- Termination in breach of some other ***implied contract term***, such as those that might be created by employee handbook provisions (in certain jurisdictions).
- Termination in violation of the doctrine of ***promissory estoppel*** (where the employee reasonably relied on an employer's promise, to the employee's detriment).
- Other exceptions as determined by ***statutes*** (such as WARN).

The number of employees is a key factor in determining whether the WARN Act is applicable. Only an employer who has 100 or more full-time employees or has 100 or more employees who, in the aggregate, work at least 4,000 hours per week are covered by the WARN Act. In counting the number of employees, U.S. citizens working at foreign sites, temporary employees, and employees working for a subsidiary as part of the parent company must be considered in the calculation.

There are three exceptions to the 60-day notice requirements. The first, referred to as the "faltering company" exception, involves an employer who is actively seeking capital and who in good faith believes that giving notice to the employees will preclude the employer from obtaining the needed capital. The second exception occurs when the required notice is not given due to a "sudden, dramatic, and unexpected" business circumstance not reasonably foreseen and outside the employers' control. The last exception is for actions arising out of a "natural disaster" such as a flood, earthquake, or drought.

Violation of Public Policy

One of the most visible exceptions that states are fairly consistent in recognizing, either through legislation or court cases, has been based on a violation of public policy. For a terminated employee to sustain a cause of action against her or his employer on this basis, the ex-employee must show that the employer's actions were motivated by *bad faith, malice, or retaliation.* At least 44 states allow this exception. Violations of public policy usually arise from the employee being terminated for acts such as refusing to violate a criminal statute on behalf of the employer or at the employer's request, exercising a statutory right, fulfilling a statutory duty, or disclosing violations of statutes by an employer.

Scenario

For instance, a state may have a law that says that qualified citizens must serve jury duty unless they come within one of the statutory exceptions. The employer does not want the employee to miss work by serving jury duty. The employee serves jury duty and is terminated by the employer. The employee sues the employer for unjust dismissal. The employer counters with the at-will doctrine, which states that the employer can terminate the employee for any reason the employer wishes to use. The Jury System Improvements Act prohibits employers from discriminating based on jury service in federal courts. States vary in terms of their protection for state and local jury service. Even in states where the protection is less clear, many courts have then held that the employer's termination of the employee under these circumstances constitutes a violation of public policy. That is, by

State Rulings Chart

Availability of common-law exceptions to the employment-at-will doctrine on state-by-state basis. Implied contract includes implications through employer policies, handbooks, promises, or other representations.

	Implied Contract	Public Policy	Good Faith and Fair Dealing
Alabama	Yes	No	No
Alaska	Yes	Yes	Yes
Arizona	Yes	Yes	Yes
Arkansas	No	Yes	No
California	Yes	Yes	Yes
Colorado	Yes	Yes	No
Connecticut	Yes	Yes	Yes
Delaware	Yes	Yes	Yes
District of Columbia	Yes	Yes	No
Florida	No	No	No
Georgia	No	No	No
Hawaii	Yes	Yes	No
Idaho	Yes	Yes	Yes
Illinois	Yes	Yes	No
Indiana	Yes	Yes	No
Iowa	Yes	Yes	No
Kansas	Yes	Yes	No
Kentucky	Yes	Yes	No
Louisiana	No	No	No
Maine	Yes	No	No
Maryland	Yes	Yes	No
Massachusetts	Yes	Yes	Yes
Michigan	Yes	Yes	No
Minnesota	Yes	Yes	No
Mississippi	No	Yes	No
Missouri	No	Yes	No
Montana	Yes	Yes	Yes
Nebraska	Yes	Yes	No
Nevada	Yes	Yes	No
New Hampshire	Yes	Yes	Yes
New Jersey	Yes	Yes	Yes
New Mexico	Yes	Yes	No
New York	Yes	No	No
North Carolina	Yes	Yes	No
North Dakota	Yes	Yes	No
Ohio	Yes	Yes	No
Oklahoma	Yes	Yes	No
Oregon	Yes	Yes	No
Pennsylvania	Yes	Yes	No
Rhode Island	NC	No	NC
South Carolina	Yes	Yes	No
South Dakota	Yes	Yes	No

(*continued*)

	Implied Contract	Public Policy	Good Faith and Fair Dealing
Tennessee	Yes	Yes	No
Texas	Yes	Yes	No
Utah	Yes	Yes	Yes
Vermont	Yes	Yes	No
Washington	Yes	Yes	No
West Virginia	Yes	Yes	No
Wisconsin	Yes	Yes	No
Wyoming	Yes	Yes	Yes

NC: No case or no clear expression.

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the legislature passing such a law requiring jury duty service, it thus has been legislatively determined that serving jury duty is a public policy that should be upheld. Thus, terminating the employee for fulfilling that statutory duty is a violation of public policy by the employer. For the court to allow an employer to terminate an employee who upholds this public policy would be inconsistent with the public policy exhibited by the statute; therefore, the employer's termination of the employee will not be upheld.

In one Washington State Supreme Court case, *Gardner* v. *Loomis Armored, Inc.,* the court ruled that an employer violated public policy when it fired an armored-truck driver after the driver left the vehicle in order to rescue a robbery hostage. In that case, the driver was making a routine stop at a bank. When he saw the bank's manager running from the bank followed by a man wielding a knife, he locked the truck's door and ran to her rescue. While the woman was saved, the driver was fired for violating his employer's policy prohibiting him from leaving his vehicle. The court held that his termination violated the public policy encouraging such "heroic conduct." Understanding the confusion sometimes left in the wake of decisions surrounding public policy, the court noted that "this holding does not create an affirmative legal duty requiring citizens to intervene in dangerous life threatening situations. We simply observe that society values and encourages voluntary rescuers when a life is in danger. Additionally, our adherence to this public policy does nothing to invalidate [the firm's] work rule regarding drivers' leaving the trucks. The rule's importance cannot be understated, and drivers do subject themselves to a great risk of harm by leaving the driver's compartment. Our holding merely forbids [the firm] from firing [the driver] when he broke the rule because he saw a woman who faced imminent life-threatening harm, and he reasonably believed his intervention was necessary to save her life. Finally, by focusing on the narrow public policy encouraging citizens to save human lives from life threatening situations, we continue to protect employers from frivolous lawsuits."[6]

On the other hand, while courts often strive to be sensitive to family obligations, a refusal to work overtime in consideration of those obligations was deemed a legal

[6] *Gardner* v. *Loomis Armored, Inc.,* 128 Wash. 2d 931, 913 P.2d 377 (1996).

basis for termination. In other words, such termination of an at-will employee did not violate a public policy or any legally recognized right or duty of the employee.[7] While the courts that have adopted the exception agree that the competing interests of employers and society require that the exception be recognized, as evidenced by the *Gardner* case, above, there is considerable disagreement in connection with what is the public policy and what constitutes a violation of the policy. In one of the leading cases in this area, the Illinois court stated that "the Achilles heel of the principle lies in the definition of public policy."

Whistle-Blowing

Some states have included "whistle-blowing" under the public policy exception. *Whistle-blowing* refers to an employee's reporting of the employer's wrongdoings. In a typical case involving whistle-blowing, the employee is fired for reporting the employer's wrongdoings. You may recall one of the most infamous cases of whistle-blowing is recent decades, Sherron Watkins' actions in connection with Enron's accounting malfeasance.

In 1982, Congress enacted the Federal Whistleblower Statute, which prohibits retaliatory action specifically against defense contractor employees who disclose information pertaining to a violation of the law governing defense contracts. The statute is administered by the Department of Defense and is enforced solely by that department; that is, an individual who suffers retaliatory action under this statute may not bring a private suit (common-law recovery in certain states continues to exist and is the subject of this section). The statute states specifically:

> An employee of a defense contractor may not be discharged, demoted, or otherwise discriminated against as a reprisal for disclosing to a Member of Congress or an authorized official of the Department of Defense or of Justice information relating to a substantial violation of law related to a defense contract (including the competition for or negotiation of a defense contract).

Additionally, in 1989 Congress amended the Civil Service Reform Act of 1978 to include the Whistleblowers Protection Act, which expands the protection afforded to federal employees who report government fraud, waste, and abuse. The act applies to all employees appointed in the civil service who are engaged in the performance of a federal function and are supervised by a federal official. Employees of federal contractors, therefore, are not covered by the act since they are hired by the contractor and not the government itself.

At least 39 states, including California, Florida, New York, and Texas, also provide some form of legislative protection for whistle-blowers. Almost half of these state whistle-blower protection statutes protect both public and private sector employees who report wrongdoings of their employer. Some states limit protection to the reporting of violation of federal, state, or local laws. However, an increasing number of states, including California, Colorado, and Illinois, protect the reporting of mismanagement or gross waste of public funds or of a substantial and specific danger to public health and safety. A few states,

[7] *Upton* v. *JWP Businessland,* 682 N.E.2d 1357 (Mass. 1997).

Exhibit 1.6 States with Whistle-Blower Protection Statutes

STATES WITH ONLY PUBLIC SECTOR WHISTLE-BLOWER PROTECTION STATUTES

Alaska, Arizona, Colorado, Delaware, Georgia,[2] Indiana, Kansas, Kentucky, Maryland,[1] Missouri, Oklahoma, Oregon, Pennsylvania,[3] South Carolina, South Dakota, Texas, Utah, Washington,[4] West Virginia, Wisconsin[2]

[1] Maryland restricts coverage to employees and classified-service applicants within the executive branch of state government.

[2] Georgia and Wisconsin exclude employees of the office of the governor, the legislature, and the courts.

[3] Pennsylvania's law excludes teachers, although school administrators are covered. Pennsylvania also has a separate law governing public utility employees.

[4] Washington has separate laws covering state employees and local government employees.

STATES WITH BOTH PRIVATE AND PUBLIC SECTOR WHISTLE-BLOWER PROTECTION

California, Connecticut,[2] Florida, Hawaii, Illinois, Iowa, Louisiana, Maine, Michigan, Minnesota,[1] New Hampshire,[1] New Jersey, New York, North Carolina, North Dakota, Ohio, Rhode Island, Tennessee[3]

[1] The laws in Minnesota and New Hampshire specifically exclude independent contractors.

[2] Connecticut has separate laws extending whistle-blower protection to public service, nuclear-power, and state and local employees who report hazardous conditions.

[3] Tennessee has two whistle-blower laws, one that covers only local school-system employees, and the other covering any employee who reports, or refuses to participate in, illegal activities.

— Separate laws in Nevada cover state employees and peace officers.

— Montana also protects public and private-sector whistle-blowers through its Wrongful Discharge from Employment Act.

Source: Bureau of National Affairs, Inc., *Individual Employment Rights Manual,* No. 133, 505:28–29 (July 2001).

such as Alaska, Maine, Louisiana, and Pennsylvania, require that whistle-blowing reports be made in "good faith." (See Exhibit 1.6.)

If there is a statute permitting an employee to take certain action or to pursue certain rights, the employer is prohibited from terminating employees for engaging in such activity. Examples of this type of legislation include state statutes permitting the employee to file a workers' compensation claim for on-the-job injuries sustained by the employee. Assume the employee files the claim and is terminated by the employer for doing so. If the employee sues for wrongful termination or retaliatory discharge, and the state is one that recognizes the public policy exception to the at-will doctrine, the employee will most likely win. Another example of legislation protecting whistle-blowers is the Sarbanes-Oxley Act, which primarily addresses issues relating to accountability and transparency in corporate governance (such as the issues that arose during the infamous Enron debacle). The act specifically provides protection to employees of publicly traded companies who disclose corporate misbehavior, even if the disclosure was made only internally to management or to the board of directors and not necessarily to relevant government authorities. The following case is a seminal one in this area, exploring whether assisting law enforcement agencies should be protected by public policy. Following *Palmateer,* the *Green* case involves an employee who continually reported inspection flaws and was fired.

Palmateer v. International Harvester Company *85 Ill.2d 124, 421 N.E.2d 876 (1981)*

Ray Palmateer had worked for International Harvester (IH) for 16 years at the time of his discharge. Palmateer sued IH for retaliatory discharge, claiming that he was terminated because he supplied information to local law enforcement authorities regarding a co-worker's criminal activities and for offering to assist in the investigation and trial of the co-worker if necessary.

Simon, J.

[The court discusses the history of the tort of retaliatory discharge in Illinois and explains that the law will not support the termination of an at-will employment relationship where the termination would contravene public policy.] But the Achilles heel of the principle lies in the definition of public policy. When a discharge contravenes public policy in any way, the employer has committed a legal wrong. However, the employer retains the right to fire workers at will in cases "where no clear mandate of public policy is involved."

There is no precise definition of the term. In general, it can be said that public policy concerns what is right and just and what affects the citizens of the State collectively. It is to be found in the State's constitution and statutes and, when they are silent, in its judicial decisions. Although there is no precise line of demarcation dividing matters that are the subject of public policies from matters purely personal, a survey of cases in other States involving retaliatory discharge shows that a matter must strike at the heart of a citizen's social rights, duties, and responsibilities before the tort will be allowed.

It is clear that Palmateer has here alleged that he was fired in violation of an established public policy. There is no public policy more basic, nothing more implicit in the concept of ordered liberty than the enforcement of a State's criminal code. There is no public policy more important or more fundamental than the one favoring the effective protection of the lives and property of citizens.

No specific constitutional or statutory provision requires a citizen to take an active part in the ferreting out and the prosecution of crime, but public policy nevertheless favors citizen crime-fighters. Public policy favors Palmateer's conduct in volunteering information to the law enforcement agency. Palmateer was under a statutory duty to further assist officials when requested to do so.

The foundation of the tort of retaliatory discharge lies in the protection of public policy, and there is a clear public policy favoring investigation and prosecution of criminal offenses. Palmateer has stated a cause of action for retaliatory discharge.

Case Questions

1. Is there a difference between the court's protection of an employee who reports a rape by a co-worker or the theft of a car, and an employee who is constantly reporting the theft of the company's paper clips and pens?
2. Should the latter employee in the above question be protected? Consider that the court in *Palmateer* remarked that "the magnitude of the crime is not the issue here. It was the General Assembly who decided that the theft of a $2 screwdriver was a problem that should be resolved by resort to the criminal justice system."
3. What are other areas of public policy that might offer protection to terminated workers?

Green v. Ralee Engineering Company *78 Cal.Rptr.2d 16 (CA. 1998)*

An employee was terminated after calling attention to the fact that parts that had failed inspection were still being shipped to purchasers. He sued for wrongful discharge, asserting a public policy exception to the at-will employment rule. The court agreed that the termination violated public policy.

Chin, J.

Richard Green was a quality control inspector for Ralee Engineering Company, a fuselage and wing component manufacturer who supplied parts to airplane assembly companies. One of Green's responsibilities included inspecting parts before they were shipped to the assembly companies. Green noticed that Ralee Engineering was shipping parts to assembly companies even when those parts failed the inspections his team had performed. During a two-year period, Green called this practice to the attention of his immediate superiors and various management personnel, including the company president. Citing a lack of business, Green was dismissed from Ralee in 1991 after serving the company for 23 years. Green admitted he was an at-will employee but filed a wrongful discharge suit for alleging that a number of less-experienced inspectors than Green were retained and that the real reason for his dismissal was retaliation for his objections to the defective parts. Green argued that the discharge fell within the nationally well-recognized exception to the at-will employment providing tort damages where an employee was discharged for a reason that violated an important public policy.

May administrative regulations be a source of fundamental public policy that limits an employer's right to discharge an otherwise at-will employee? Although our legislature has determined that an employment contract is generally terminable at either party's will, we have created a narrow exception to this rule by recognizing that an employer's right to discharge an at-will employee is subject to limits that fundamental public policy imposes. At-will employees may recover tort damages from their employers if they can show they were discharged in contravention of fundamental public policy.

Employees who assert wrongful discharge claims must show that the important public interests they seek to protect are "tethered to fundamental policies that are delineated in constitutional or statutory provisions." Here, we address a related, albeit narrow issue. We must decide whether particular administrative regulations implementing the Federal Aviation Act of 1958, a public safety statute that created the Federal Aviation Administration (FAA), should be included as a source of fundamental public policy that limits an employer's right to discharge an at-will employee. Like the Court of Appeal, we conclude they should.

We continue to believe that, aside from constitutional policy, the legislature, and not the courts, is vested with the responsibility to declare the public policy of the state. Recognizing this important distinction, however, does not allow us to ignore the fact that statutorily authorized regulations that effectuate the legislature's purpose to ensure commercial airline safety are "tethered to" statutory provisions. . . .

* * *

Defendant argues principally that, even if we assume it did everything plaintiff claimed, its conduct violated no public policy embodied in a constitutional or statutory provision. Consequently, defendant argues, plaintiff's discharge fails to qualify as a wrongful discharge.

As we explain, we agree with the Court of Appeal in concluding that the federal safety regulations promulgated to address important public safety concerns may serve as a source of fundamental public policy. The regulations satisfy our requirement that the action be tethered to fundamental policies delineated in a statutory or constitutional provision. . . .

* * *

Public policy cases fall into one of four categories: the employee (1) refused to violate a statute; (2) performed a statutory obligation; (3) exercised a constitutional or statutory right or privilege; or (4) reported a statutory violation for the public's benefit. . . . In order to provide an exception to the at-will mandate, the policy must be "public" in that it "affects society at large" rather than the individual, must have been articulated at the time of discharge, and must be "fundamental" and "substantial."

The limitation on public policy sources (that they must be supported by either constitutional or statutory provisions) grew from our belief that "public policy as a concept is notoriously resistant to precise definition, and that courts should venture into this area, if at all, with great care and due deference to the judgment of the legislative branch" in order to avoid judicial policymaking. . . .

* * *

. . . The question we now address is whether important public safety regulations governing commercial airline safety may provide a basis for declaring a public policy in the context of a retaliatory discharge action.

Federal regulations promoting the proper manufacture and inspection of component airline parts advance the important public policy objectives. In the Federal Aviation Act of 1958 Congress declared the public interest in commercial air safety. . . .

* * *

Plaintiff performed the FAA-required inspections on the parts intended for use in Boeing aircraft to further a fundamental policy: "to ensure that each article

produced conforms to the type design and is in a condition for safe operation." Therefore, this regulation-based fundamental public policy may serve as the foundation for plaintiff's claim. It furthers important safety policies affecting the public at large and does not merely serve either the employee's or employer's personal or proprietary interest. As we noted, "[t]here is no public policy more important or more fundamental than the one favoring the effective protection of the lives and property of citizens."

* * *

We emphasize that not all administrative regulations can support such claims, but only those that implicate substantial public policies. It is insufficient for employees to allege that they were discharged for refusing to violate a statute or follow a statutory duty; they must also allege that the statute in question was designed to protect the public or advance some substantial public policy goal. Employees must do the same when alleging a discharge for refusing to follow administrative regulations that implement an important statutory objective. In the case of both statutes and regulations based on statutes, courts must distinguish between those that promote a "clearly mandated public policy" and those that do not. . . .

We conclude that the public policy behind federal regulations concerning airline safety has a basis in statutory provisions, consistent with our rule that the public policy giving rise to a wrongful termination action have a basis in a constitutional or statutory provision. Congress has specifically directed the FAA to assign, maintain, and enhance safety and security as the highest priorities in air commerce and to regulate air commerce "in a way that best promotes its safety." Our judicial decisions favor protecting employees who vindicate important public policy interests. Allowing defendant to discharge plaintiff with impunity after he sought to halt or eliminate its alleged inspection practices would only undermine the important and fundamental public policy favoring safe air travel. By including significant administrative safety regulations promulgated to serve important FAA mandates as a source of fundamental public policy limiting an employer's right to discharge an otherwise at-will employee, we effectively guarantee that employers do not exercise their right to terminate their employees at will in a way that undermines more important public safety objectives. AFFIRMED and REMANDED.

Case Questions

1. Not all the justices agreed with this opinion. Do you agree with the majority's opinion? Why or why not?
2. Do you think an important factor in this case was the airline industry and the fact that safety of air travel was an issue?
3. The court notes that it should determine what policy should be considered "public policies" in relation to these types of causes of action. Do you agree? Who do you think should determine such public policies—the courts, the legislature (state or federal), employers, or employees?

public policy
A legal concept intended to ensure that no individual lawfully do that which has a tendency to be injurious to the public or against the public good. Public policy is undermined by anything that harms a sense of individual rights.

In determining what exactly constitutes **public policy**, one should consider two factors: *clarity and impact.* In evaluating the clarity, or substantiality, of the policy, the employer should look to both the definiteness and weight of the policy. For instance, a statute that specifically protects individuals from discharge if they leave work to tend to a family emergency clearly articulates a public policy in that regard. On the other hand, if the basis for the employee's claim of public policy is one line in the legislative history of the statute, which was not later incorporated into the statute, such a public concern may lack the needed clarity to support the claim.

Generally, courts require that the statement of public policy be rooted in a statutory or constitutional provision. In that way, courts are able to maintain some type of consistency among cases. This allows managers some degree of predictability in terms of the consequences of their employment decisions.

In evaluating the impact of the public policy, the employer should look to the impact of the discharge on the public interest served by the policy. For instance, will this discharge discourage others from exercising their rights or discourage compliance with that policy,

and, therefore, frustrate the policy itself? Further, is the satisfaction of that policy dependent on the cooperation of the employees, and would such cooperation also be impacted? Accordingly, the focus in the latter inquiry is not on the effect of the discharge on this individual employee but on society as a whole and the future impact of the policy. As noted by one scholar in this area, the burden on the individual discharged employee is insufficient to support a cause of action because it is offset by the employer's legitimate interests in maximizing employee control, efficiency, and productivity.

Other reasons for termination that, at first blush, appear to be solid bases for claims of wrongful termination may not be protected. For example, where an employee was discharged for seeking the assistance of an attorney after receiving a poor evaluation, the Seventh Circuit Court of Appeals held that the termination was proper. An employee's discharge for performing acts that one would like to believe society should encourage is not necessarily protected. The outcome in a particular case will depend on the precedent of the jurisdiction in which the termination occurs.

While some states allow these exceptions articulated above, but do not allow for an extension of the doctrine beyond that, other states remain reticent in their denial of the public policy exception to at-will employment. For instance, though it seems counterintuitive, the appellate court in New York held that an employee who was terminated for refusing to participate in illegal schemes designed to defraud the IRS, and for reporting these activities to a supervisor, could not maintain an action for wrongful discharge.

Supporting this line of court decisions is the principle that any modification to at-will employment should come from the legislature, either state or federal. Where there is a clear statement of public policy from the legislature, these courts are more likely to allow the public policy exception. However, where no clear mandate exists, the courts posit that any declaration of public policy would entail stepping over the line that divides the formation of law and the application of law.

Breach of Implied Covenant of Good Faith and Fair Dealing

Another exception to the at-will employment presumption is the implied duty of good faith and fair dealing in the performance and enforcement of every contract. This requirement should not be confused with a contractual requirement of "good cause" prior to termination; an employer can terminate a worker for good cause under a contract. A New York court defined the duty as follows:

> In every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing. While the public policy exception to the at-will doctrine looks to the law to judge the employer's actions and deems them violations of public policy or not, the breach of implied covenant of good faith looks instead to the actions between the parties to do so.

covenant of good faith and fair dealing
Implied contractual obligation to act in good faith in the fulfillment of each party's contractual duties.

Where the implied **covenant of good faith and fair dealing** is recognized as an exception to the at-will doctrine, courts have implied that any agreement between the employer has inherent in it, unless specifically excluded, a promise that the parties will deal with each other fairly and in good faith. Consider the situation where the employer

and employee may have entered into a contract of employment, but the particulars of why and when an employee could be terminated were not specifically addressed in the parties' contractual agreements. Assume the employee is then terminated for what the employee believes is an unwarranted reason, but the court looks to the contract and finds that the matter is not covered by the contract. The court will then look to the facts to see whether the termination is valid under the contract or in breach of the implied covenant of good faith and fair dealing.

Only 13 states recognize this covenant as an exception to at-will employment: Some states allow the cause of action but limit the damages awarded to those that would be awarded under a breach of contract claim, while other states allow the terminated employee to recover higher tort damages.

Scenario

In connection with scenario 2, discussed at the beginning of the chapter, Mark Richter may have a claim against his employer for breach of the covenant of good faith and fair dealing. Mark's employer is, in effect, denying Mark the fruits of his labor.

Critics of this implied agreement argue that, where an agreement is specifically nondurational, there should be no expectation of guaranteed employment of any length. As long as both parties are aware that the relationship may be terminated at any time, it would be extremely difficult to prove that either party acted in bad faith in terminating the relationship. Courts have supported this contention in holding that the implied covenant does not recognize the balance between the employee's interest in maintaining her or his employment and the employer's interest in running its business as it sees fit. "The absence of good cause to discharge an employee does not alone give rise to an enforceable claim for breach of a condition of good faith and fair dealing." To the contrary, employers may terminate an individual for any reason, as long as the true reason is not contradictory to public policy, against the law, and in contravention of another agreement. The case below seeks to clarify this distinction.

Guz v. Bechtel Nat. Inc. *100 Cal.Rptr.2d 352 (Ca. 2000)*

Plaintiff John Guz, a longtime employee of Bechtel National, Inc. (BNI), was terminated at age 49 when his work unit was eliminated as a way to reduce costs. At the time he was hired and at his termination, Bechtel maintained Personnel Policy 1101 on the subject of termination of employment which stated that "Bechtel employees have no employment agreements guaranteeing continuous service and may resign at their option or be terminated at the option of Bechtel." Guz sued BNI and its parent, Bechtel Corporation, alleging age discrimination, breach of an implied contract to be terminated only for good cause, and breach of the implied covenant of good faith and fair dealing. The trial court granted Bechtel's motion for summary judgment and dismissed the action. In a split decision, the Court of Appeal reversed. The majority found that Bechtel had demonstrated no grounds to foreclose a trial on any of the claims asserted in the complaint. The Supreme Court of California reverses the judgment of the Court of Appeals and remands.

* * *

Baxter, J.

III. Implied covenant claim

Bechtel next urges that the trial court properly dismissed Guz's separate claim for breach of the implied covenant of good faith and fair dealing because, on the facts and arguments presented, this theory of recovery is either inapplicable or superfluous. We agree.

The sole asserted basis for Guz's implied covenant claim is that Bechtel violated its established personnel

policies when it terminated him without a prior opportunity to improve his "unsatisfactory" performance, used no force ranking or other objective criteria when selecting him for layoff, and omitted to consider him for other positions for which he was qualified. Guz urges that *even if his contract was for employment at will,* the implied covenant of good faith and fair dealing precluded Bechtel from "unfairly" denying him the contract's benefits by failing to follow its own termination policies.

Thus, Guz argues, in effect, that the implied covenant can impose substantive terms and conditions beyond those to which the contract parties actually agreed. However, as indicated above, such a theory directly contradicts our conclusions in *Foley* v. *Interactive Data Corp.* (1988). The covenant of good faith and fair dealing, implied by law in every contract, exists merely to prevent one contracting party from unfairly frustrating the other party's right to receive the *benefits of the agreement actually made.* The covenant thus cannot "be endowed with an existence independent of its contractual underpinnings." It cannot impose substantive duties or limits on the contracting parties beyond those incorporated in the specific terms of their agreement.

. . . The mere existence of an employment relationship affords no expectation, protectible by law, that employment will continue, or will end only on certain conditions, unless the parties have actually adopted such terms. Thus if the employer's termination decisions, however arbitrary, do not breach such a substantive contract provision, they are not precluded by the covenant.

This logic led us to emphasize in *Foley* that "breach of the implied covenant cannot logically be based on a claim that [the] discharge [of an at-will employee] was made without good cause." As we noted, "[b]ecause the implied covenant protects only the parties' right to receive the benefit of their agreement, and, in an at-will relationship there is no agreement to terminate only for good cause, the implied covenant standing alone cannot be read to impose such a duty."

The same reasoning applies to any case where an employee argues that even if his employment was at will, his arbitrary dismissal frustrated his contract benefits and thus violated the implied covenant of good faith and fair dealing. Precisely because employment at will *allows* the employer freedom to terminate the relationship as it chooses, the employer does not frustrate the employee's contractual rights merely by doing so. In such a case, "the employee cannot complain about a deprivation of the benefits of continued employment, for the agreement never provided for a continuation of its benefits in the first instance."

Guz cites several decisions suggesting that the implied covenant precludes an employer from terminating even an at-will employee unfairly, such as by refusing to follow its own established policies and practices. (*Rulon-Miller* v. *International Business Machines Corp.* (1984) [employer's duty of fair dealing requires that "like cases be treated alike"; thus, employer's termination rules and regulations, if any, must be followed]; see *Gray* v. *Superior Court* (1988) [long service plus violation of employer policies may establish breach of covenant of "fair treatment"]; *Pugh* v. *See's Candies, Inc.* (1981) [termination after long service, in violation of employer policies, may breach implied covenant to refrain from arbitrary treatment]; see also *Kern v. Levolor Lorentzen, Inc.* (1990) [covenant requires "cooperation in carrying out the contract and honesty in creating or settling disputes"; breach of covenant may thus be shown where employee establishes lengthy satisfactory service and violation of employer's termination policies].) But insofar as these authorities suggest that the implied covenant may impose limits on an employer's termination rights beyond those either expressed or implied in fact in the employment contract itself, they contravene the persuasive reasoning of *Foley,* and are therefore disapproved.

Similarly at odds with *Foley* are suggestions that independent recovery for breach of the implied covenant may be available if the employer terminated the employee in "bad faith" or "without probable cause," i.e., without determining "honestly and in good faith that good cause for discharge existed." Where the employment contract itself allows the employer to terminate at will, its motive and lack of care in doing so are, in most cases at least, irrelevant.

A number of Court of Appeal decisions since *Foley* have recognized that the implied covenant of good faith and fair dealing imposes no independent limits on an employer's prerogative to dismiss employees. (E.g., *Camp* v. *Jeffer, Mangels, Butler & Marmaro* (1995) [implied covenant did not preclude unfair termination where there was no express or implied-in-fact contract limiting employer's termination rights]; *Flait* v. *North American Watch Corp.* (1992) [employment contract contained express at-will term; because employee thus could not show her termination broke any "contractual

covenant or promise," implied covenant claim must fail]; *Slivinsky* v. *Watkins-Johnson Co.* (1990) [where contract contained express at-will clause, implied covenant claim must fail because employee could not show her termination without good cause frustrated "the [parties'] intentions and reasonable expectations . . . within the contract"].) We affirm that this is the law.

Of course, as we have indicated above, the employer's personnel policies and practices may become *implied-in-fact terms* of the contract between employer and employee. If that has occurred, the employer's failure to follow such policies when terminating an employee is a breach of the contract itself.

A breach of the contract may also constitute a breach of the implied covenant of good faith and fair dealing. But insofar as the employer's acts are directly actionable as a breach of an implied-in-fact contract term, a claim that merely realleges that breach as a violation of the covenant is superfluous. This is because, as we explained at length in *Foley,* the remedy for breach of an employment agreement, including the covenant of good faith and fair dealing implied by law therein, is *solely contractual*. In the employment context, an implied covenant theory affords no separate *measure of recovery,* such as tort damages. Allegations that the breach was wrongful, in bad faith, arbitrary, and unfair are unavailing; there is no tort of "bad faith breach" of an employment contract.

We adhere to these principles here. To the extent Guz's implied covenant cause of action seeks to impose limits on Bechtel's termination rights *beyond* those to which the parties actually agreed, the claim is invalid. To the extent the implied covenant claim seeks simply to invoke terms to which the parties *did* agree, it is superfluous. Guz's remedy, if any, for Bechtel's alleged violation of its personnel policies depends on proof that they were contract terms to which the parties actually agreed. The trial court thus properly dismissed the implied covenant cause of action.[8]

Case Questions

1. Based on *Guz,* can the implied covenant of good faith and fair dealing apply to any conditions not actually stated in a contract? In other words, can the covenant apply to anything beyond that which is actually stated in an employment contract, if any? If not, is there no implied covenant as long as someone is at-will without a contract?
2. Are you more persuaded by the cases cited by the court in favor of a holding that the implied covenant precludes an employer from terminating even an at-will employee unfairly, or the *Foley* decision which held that the covenant "cannot impose substantive duties or limits on the contracting parties beyond those incorporated in the specific terms of their agreement"?
3. Explain the distinction between the court's discussion of the covenant of good faith and fair dealing and the possibility of an implied contract term (see also the next section in this chapter).

[8] We do not suggest the covenant of good faith and fair dealing has no function whatever in the interpretation and enforcement of employment contracts. As indicated above, the covenant prevents a party from acting in bad faith to frustrate the contract's *actual* benefits. Thus, for example, the covenant might be violated if termination of an at-will employee was a mere pretext to cheat the worker out of another contract benefit to which the employee was clearly entitled, such as compensation already earned. We confront no such claim here.

Breach of Implied Contract

implied contract
A contract that is not expressed, but, instead, is created by other words or conduct of the parties involved.

What happens when the employer is not violating an express contractual agreement, yet there seems to be an injustice done? That is where the theory of **implied contracts** comes in. The court finds such contracts from several different sources. Primarily, an implied contract arises from the acts of the parties; the acts leading to the creation of an implied contract vary from situation to situation.

Employers should be aware of the implied contract. In recent years, courts have been willing to find contracts implied from statements made during preemployment

interviews about the candidate becoming a "permanent" employee or from conversations quoting yearly or other periodic salaries. In such cases, when the employee has been terminated in less than the time quoted in the salary (e.g., telling the employee the job pays $50,000 per year), then the employee has been able to maintain an action for the remainder of the salary on the theory that there was an implied contract created of a year's duration. If the employee is released before the end of that year, for other than good cause, the termination may result in liability for the salary remaining on the year's contract. The court considers what implied contract obligations an employer may have created in the following case.

Torosyan v. Boehringer Ingelheim Pharmaceuticals, Inc.

662 A.2d 89 (Conn. 1995)

After being given assurances of job security, an applicant was hired, then later terminated. The employee sued for a breach of an implied contract, using statements made by the employer as the basis of his claim. The court permitted the cause of action to survive a motion to dismiss.

Peters, C. J.

At the outset, we note that all employer–employee relationships not governed by express contracts involve some type of implied "contract" of employment. "There cannot be any serious dispute that there is a bargain of some kind; otherwise, the employee would not be working." To determine the contents of any particular implied contract of employment, the factual circumstances of the parties' relationship must be examined in light of legal rules governing unilateral contracts.

Pursuant to the legal principles governing such contracts, in order to find that an implied contract of employment incorporates specific representations orally made by the employer or contained in provisions in an employee manual, the trier of fact is required to find the following subordinate facts. Initially, the trier of fact is required to find that the employer's oral representations or issuance of a handbook to the employee was an "offer"—i.e., that it was a promise to the employee that, if the employee worked for the company, his or her employment would thereafter be governed by those oral or written statements, or both. If the oral representations and/or the handbook constitute an "offer," the trier of fact then is required to find that the employee accepted that offer. Subsequent oral representations or the issuance of subsequent handbooks must be evaluated by the same criteria. To be incorporated into the implied contract of employment, any such representation or handbook must constitute an offer to modify the preexisting terms of employment by substituting a new implied contract for the old. Furthermore, the proposed modifications, like the original offers, must be accepted.

Typically, an implied contract of employment does not limit the terminability of an employee's employment but merely includes terms specifying wages, working hours, job responsibilities, and the like. Thus "[a]s a general rule, contracts of permanent employment, or for an indefinite term, are terminable at will."

* * *

. . . The plaintiff testified that certain statements were made to him in the context of an employment interview in direct response to his inquiries about job security. One of those statements was that if the plaintiff did a good job, the defendant would take care of him. Another statement was that the plaintiff's employment would be governed by an employment manual. The offer letter sent to the plaintiff neither stated that it contained the entire terms of the employment offer nor disclaimed any guarantees of job security. The defendant's oral representations were material to the plaintiff's decision to move from California and accept employment with the defendant. The employee manual was provided to the plaintiff on the first day of work,

and he immediately proceeded to read it to ensure that it was consistent with the defendant's representations. The manual explicitly qualified the defendant's right to discharge with the words "for cause." The manual also stated that every employee could speak to an executive officer about "job-related problems which [he or she] may feel cannot be worked out successfully with [his or her] immediate supervisor or manager." Finally, after reading the manual, the plaintiff continued to work for the defendant for several years.

* * *

Because the defendant does not allege that there was "just cause" for the discharge in the absence of actual falsification of documents by the plaintiff, we AFFIRM the trial court's determination in this case that there was no cause for the plaintiff's discharge.

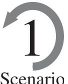
Case Questions

1. Do you agree with the court's decision? Why or why not?
2. If the employer had later distributed a new manual that specifically stated that all workers were subject to "at-will" employment, would this case have been decided differently?
3. What can companies do to avoid liability like that found in the above case?

Notwithstanding some of the court's comments in the above case, the Supreme Court in North Carolina held to the contrary:

> This court has repeatedly held that in the absence of a contractual agreement between an employer and an employee establishing a definite term of employment, the relationship is presumed to be terminable at the will of either party, without regard to the quality of performance of either party . . . "If you do your job, you'll have a job," is not sufficient to make this indefinite hiring terminable only for cause. *Kurtzman* v. *Applied Analytical Inds., Inc.,* 493 S.E.2d 420 (N.C. 1997).

In addition, the court noted that there should be no exception based on an employee's decision to move her or his residence or other burdens that the new position might have placed on the employee.



Regarding scenario 1, Emma Bina may have a claim against her new employer based on a breach of an implied employment contract. Emma accepted her position with the understanding that, in exchange for sacrificing her previous position and the sale of her house, and so on, she would be employed as long as she performed satisfactory work. Her work was more than satisfactory, yet she still lost her job. If this could have been avoided (i.e., the company did not go bankrupt or something similar), she might have a claim. (The majority of courts would agree with the *Torosyan* decision.)

Implied Contract Based on Employment Policy Manuals and Handbooks

Employment policy manuals may, in fact, form an implied contract. Employers use policy manuals as a means of organizing workplace policies and communicating them to employees. Employment policy manuals are the most logical way to handle the matter of workplace policies, because they present the employee, manager, and supervisor with one central place to search for policies when issues arise. However, employment policy manuals may present problems by unwittingly creating contracts of employment that limit the at-will nature of the employment relationship in which the employer maintains such a modicum of control over the duration of the employment relationship. Instead, the employee may have an implied contract, which may not be to the employer's advantage. Nobody wants to become bound to a contract when they are not even aware that they are doing so.

Many state courts have held that the rules and regulations set forth in an employee handbook or policy manual may form a contract between the employer and employee. The employee, by accepting the employment, becomes bound by the policies, as does the employer. As discussed in the *Guz* case earlier, the employer's failure to then abide by the policies may be cause of subsequent litigation and liability toward an employee harmed by the employee's failure to do so. Employers should be careful when creating an employment policy manual that includes a statement that employees will only be terminated for good cause, or that employees become "permanent" employees once the successfully complete their probationary period. These have been held to create binding agreements between the employer and employee, and the employer's later termination of the employee, inconsistent with those statements, has resulted in liability.

Some employers have tried to avoid the characterization of their employment policies or handbooks as potential contract terms by including in those documents a disclaimer such as the following:

> Our employment relationship is to be considered "at-will" as that term is defined in this state. Nothing in this policy [or handbook] shall be construed as a modification to that characterization and, where there is an apparent conflict between the statements in this policy [or handbook], the policy [or handbook] shall be construed to support a determination of an at-will relationship or shall become null.

Some states have statutorily addressed this issue by delineating the type of disclaimer that will be accepted in that state. For instance, in South Carolina, a disclaimer in a handbook or personnel manual to be valid must be underlined and in capital letters on the first page of the document and the document must be signed by the employee verifying that the employee has read and understood that statement. Disclaimers in other employment-related documents must satisfy the other requirements but need not be signed.

More often, states have addressed this issue in their courts rather than by specific statute. Courts regularly require that the disclaimers be clear, prominent, conspicuous, unambiguous, and an employee signature is often required. Notwithstanding the language above, disclaimers that conflict with other language in that document or in employee handbooks or policies may be rendered null by the courts.

In one case, *Steve Hicks* v. *Methodist Medical Center,*[9] plaintiff Steven Hicks was terminated in violation of his employee handbook. The defendant Methodist Medical Center claimed that it was allowed to modify the handbook at any time pursuant to a disclaimer found in the book. The court held that, in order to negate any promises made in contract provisions, a disclaimer must be "conspicuous." Since the disclaimer was located at page 38 of the handbook, was not highlighted, printed in capital letters, or in any way prominently displayed, the disclaimer was not conspicuous and so did not negate the promises made in the handbook's provisions. The court therefore found that a contract existed.

Exception Based on Promissory Estoppel

Promissory estoppel is another form of exception to the at-will rule. Promissory estoppel is similar to the implied contract claim except that the promise, implied or express, does not rise to the level of a contract. Perhaps there is no mutual consideration or some

[9] 593 N.E.2d 119 (Ill. App. 3d 1992).

other flaw; however, a plaintiff filing a claim based on promissory estoppel may still be able to refute an employer's contention of an at-will environment. For estoppel to attach, the plaintiff must show that the employer or prospective employer made a promise upon which the work reasonably relied to her or his detriment. Often the case turns on whether it was reasonable for the worker to rely on the employer's promise without an underlying contract. In addition, it is critical to have a clear and unambiguous promise. In a 2004 case, the worker believed that he had a position at DaimlerChrysler until he retired. He based his belief on exchanges during interviews for a position in which he told interviewers that he expected to hold the new position for another 12 to 15 years. In reviewing the facts of the case, the court held that, though promissory estoppel is a perfectly acceptable basis on which to find an at-will exception, "there is no evidence that Gunthorpe was promised continued employment" in his new position. "His subjective expectations are irrelevant."[10]

INTRODUCTION TO WRONGFUL DISCHARGE

In November 2001, a Texas jury awarded a former employee who was wrongfully terminated $30.5 million in damages. In March 2000, a federal jury in California deliberated just half a day before awarding more than $500,000 to a scientist who claimed she had been fired from Stanford University Medical School for complaining about sexual discrimination. Do these sound like judgments you want to have to pay to employees or ex-employees out of the coffers of your business? Probably not. You can think of far better ways to spend your money. After all, you're in business to *make* money, not to hand it away. But such judgments, rather than becoming less frequent, are becoming more so. Risk managers should also be aware that under Title VII, claims of discriminatory termination may result not only in reinstatement but in **compensatory** and **punitive damages** awards. While these statutory damages are "capped" at amounts dependent on the size of the employer, judges are allowed to, for example, award attorney's fees to the prevailing party in successful Title VII actions, sending the total judgment well into six or seven figures.

compensatory damages
Money damages given to a party to compensate for direct losses due to an injury suffered.

punitive damages
Money damages designed to punish flagrant wrongdoers and to deter them and others from engaging in similar conduct in the future.

As discussed above, if there is no express agreement or contract to the contrary, employment is considered to be at will; that is, either the employer or the employee may terminate the relationship at their will. Nevertheless, even where a discharge involves no statutory discrimination, breach of contract, or traditional exception to the at-will doctrine discussed above, the termination may still be considered wrongful and the employer may be liable for "wrongful discharge," "wrongful termination," or "unjust dismissal." Therefore, in addition to ensuring that workplace policies do not wrongfully discriminate against employees, and do not fall under other exceptions, the employer must also beware of situations in which the employer's policy or action in a particular termination can form the basis for unjust dismissal. Since such bases can be so diverse, the employer must be vigilant in watching this area, and employees must be fully aware of their rights, even though the relationship may be considered at will.

[10] *Gunthorpe* v. *DaimlerChrysler Corp.,* 90 Fed. App. 877 (6th Cir. 2004).

Constructive Discharge

constructive discharge
Occurs when the employee is given no reasonable alternative but to terminate the employment relationship; considered an involuntary act on the part of the employee.

The "discharge" addressed in this chapter may refer either to "firing" or to an employee's decision to leave under certain circumstances. **Constructive discharge** exists where the employee is given no alternative but to quit her or his position; that is, the act of leaving was not truly voluntary. Therefore, while the employer did not actually fire the employee, it was the actions of the employer that *caused* the employee to leave. Constructive discharge usually evolves from circumstances where an employer knows that it cannot really terminate an employee for one reason or another. So, to avoid being sued for wrongful termination, the employer creates an environment where the employee has no choice but to leave. If courts were to allow this type of treatment, those laws that restrict employers' actions from wrongful termination, such as Title VII, would have no effect.

The test for constructive discharge is whether the employer made the working conditions *so intolerable that no reasonable employee should be expected to endure.* A 2004 opinion further explained that "an employee's work environment need not be literally unbearable in order to effect a constructive discharge. It is enough that the employee has no recourse within the employer's organization or reasonably believes there is no chance for fair treatment."[11] A minority of courts hold that the former employee must also show that the employer created the intolerable working conditions *with the specific intent of forcing the employee to quit.* However, this intent can be inferred where the employee's departure is a reasonably foreseeable consequence of the employer's actions.[12] Finally, to find constructive discharge, the circumstances complained of must be aggravated, which may occur where there is one horrible event or a number of minor instances of hostile behavior. Consider whether the following case satisfies this definition.

[11] *Van Meter Industries* v. *Mason CIty Human Rights Commission,* No. 107/02-1161 (Ind. 2004).

[12] *Martin v. Cavalier Hotel Corp.,* 67 FEP Cases 300 (4th Cir. 1995).

Pennsylvania State Police v. Suders *Dkt. No. 03-95, — S.Ct. —, 2004 WL 1300153 (2004)*

In March 1998, the Pennsylvania State Police (PSP) hired plaintiff–respondent Suders to work as a police communications operator for the McConnellsburg barracks, where her male supervisors subjected her to a continuous barrage of sexual harassment. In June 1998, Suders told the PSP's Equal Employment Opportunity Officer, Virginia Smith-Elliott, that she might need help, but neither woman followed up on the conversation. Two months later, Suders contacted Smith-Elliott again, this time reporting that she was being harassed and was afraid. Smith-Elliott told Suders to file a complaint, but did not tell her how to obtain the necessary form. Two days later, Suders' supervisors arrested her for theft of her own computer-skills exam papers. Suders had removed the papers after concluding that the supervisors had falsely reported that she had repeatedly failed, when in fact, the exams were never forwarded for grading. Suders then resigned from the force and sued the PSP, claiming sexual harassment and constructive discharge, in violation of Title VII.

The District Court granted the PSP's motion for summary judgment, finding that the PSP was not vicariously liable for the supervisors' conduct. In support of its decision, the District Court referred to *Faragher* v. *Boca Raton* and *Burlington Industries, Inc*. v. *Ellerth* (see also Chapter 7), where the Supreme Court held that an employer is only liable for supervisor harassment where there is a "tangible employment action, such as discharge, demotion, or undesirable reassignment." Where there is no tangible action, the employer may raise an affirmative defense to liability. To prevail on the basis of that defense, the employer must prove that (1) it exercised reasonable care to prevent and correct promptly any sexually harassing behavior, and that (2) the employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise. Suders' hostile work environment [suit] failed according to the District Court because she unreasonably failed to avail herself of the PSP's internal anti-harassment procedures.

The Third Circuit reversed and remanded the case for trial, disagreeing with the District Court in two key respects: First, even with an affirmative defense, there remained genuine issues of material fact about the effectiveness of the PSP's program to address sexual harassment claims; second, Suders had stated a claim of constructive discharge due to hostile work environment that the lower court failed to address. The appeals court ruled that a constructive discharge, if proved, constitutes a tangible employment action that renders an employer strictly liable and precludes recourse to the Ellerth/Faragher affirmative defense.

The Supreme Court reviewed and identifies the prima facie case of constructive discharge using harassment as a basis. The court concludes that there is a difference between those cases where there is an official act of a supervisor that constitutes the adverse employment action, and those cases where the discharge itself is intended to constitute the adverse employment action. It concludes that an employer does not have recourse to the Ellerth/Faragher affirmative defense in the former case, but that the defense is available to the employer whose supervisors are charged with harassment without an additional precipitating act. It therefore vacates the Third Circuit's judgment and remands the case for further proceedings.

Ginsburg delivered the opinion of the Court, in which Rehnquist, and Stevens, O'Connor, Scalia, Kennedy, Souter, and Breyer joined. Thomas filed a dissenting opinion.

Plaintiff–respondent Nancy Drew Suders alleged sexually harassing conduct by her supervisors, officers of the Pennsylvania State Police (PSP), of such severity she was forced to resign. The question presented concerns the proof burdens parties bear when a sexual harassment/constructive discharge claim of that character is asserted under Title VII of the Civil Rights Act of 1964.

To establish hostile work environment, plaintiffs. like Suders must show harassing behavior "sufficiently severe or pervasive to alter the conditions of [their] employment." *Meritor Savmgs Bank, FSB* v. *Vinson*. . . Beyond that, we hold, to establish "constructive discharge," the plaintiff must make a further showing: She must show that the abusive working environment became so intolerable that her resignation qualified as a fitting response. An employer may defend against such a claim by showing both (1) that it had installed a readily accessible and effective policy for reporting and resolving complaints of sexual harassment, and (2) that the plaintiff unreasonably failed to avail herself of that employer-provided preventive or remedial apparatus. This affirmative defense will not be available to the employer, however, if the plaintiff quits in reasonable response to an employer-sanctioned adverse action officially changing her employment status or situation, for example, a humiliating demotion, extreme cut in pay, or transfer to a position in which she would face unbearable working conditions. In so ruling today, we follow the path marked by our 1998 decisions in *Burlington Industries, Inc.* v. *Ellerth,* and *Faragher* v. *Boca Raton.*

I

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The Court of Appeals then made the ruling challenged here: It held that "a constructive discharge, when proved, constitutes a tangible employment action." Under *Ellerth* and *Faragher,* the court observed, such an action renders an employer strictly liable and precludes employer recourse to the affirmative defense announced in those decisions. The Third Circuit recognized that the Courts of Appeals for the Second and Sixth Circuits had ruled otherwise. A constructive discharge resulting from a supervisor-created hostile work environment, both Circuits had held, does not qualify as a tangible employment action, and therefore does not stop an employer from invoking

the *Ellerth*/*Faragher* affirmative defense. The Third Circuit, however, reasoned that a constructive discharge "'constitutes a significant change in employment status' by ending the employer–employee relationship" and "also inflicts the same type of 'direct economic harm'" as the tangible employment actions *Ellerth* and *Faragher* offered by way of example (discharge, demotion, undesirable reassignment). Satisfied that Suders had "raised genuine issues of material fact as to her claim of constructive discharge," and that the PSP was "precluded from asserting the affirmative defense to liability advanced in support of its motion for summary judgment," the Court of Appeals remanded Suders' Title VII claim for trial.

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II

A

Under the constructive discharge doctrine, an employee's reasonable decision to resign because of unendurable working conditions is assimilated to a formal discharge for remedial purposes. The inquiry is objective: Did working conditions become so intolerable that a reasonable person in the employee's position would have felt compelled to resign?

***

B

This case concerns an employer's liability for one subset of Title VII constructive discharge claims: constructive discharge resulting from sexual harassment, or "hostile work environment," attributable to a supervisor. Our starting point is the framework *Ellerth* and *Faragher* established to govern employer liability for sexual harassment by supervisors. As earlier noted, those decisions delineate two categories of hostile work environment claims: (1) harassment that "culminates in a tangible employment action," for which employers are strictly liable, and (2) harassment that takes place in the absence of a tangible employment action, to which employers may assert an affirmative defense. With the background set out above in mind, we turn to the key issues here at stake: Into which *Ellerth/Faragher* category do hostile-environment constructive discharge claims fall—and what proof burdens do the parties bear in such cases? In *Ellerth* and *Faragher,* the plaintiffs–employees sought to hold their employers vicariously liable for sexual harassment by their supervisors, even though the plaintiffs "suffer[ed] no adverse, tangible job consequences.". . .

. . . [W]e held that when no tangible employment action is taken, the employer may defeat vicarious liability for supervisor harassment by establishing, as an affirmative defense, both that "the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior," and that "the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise."

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1

. . . A hostile-environment constructive discharge claim entails something more: A plaintiff who advances such a compound claim must show working conditions so intolerable that a reasonable person would have felt compelled to resign.

Suders' claim is of the same genre as the hostile work environment claims the Court analyzed in *Ellerth* and *Faragher*. Essentially, Suders presents a "worse case" harassment scenario, harassment ratcheted up to the breaking point. Like the harassment considered in our pathmaking decisions, harassment so intolerable as to cause a resignation may be effected through co-worker conduct, unofficial supervisory conduct, or official company acts. Unlike an actual termination, which is *always* effected through an official act of the company, a constructive discharge need not be. A constructive discharge involves both an employee's decision to leave and precipitating conduct: The former involves no official action; the latter, like a harassment claim without any constructive discharge assertion, may or may not involve official action.

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2

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Following *Ellerth* and *Faragher*, the plaintiff who alleges no tangible employment action has the duty to mitigate harm, but the defendant bears the burden to allege and prove that the plaintiff failed in that regard. The plaintiff might elect to allege facts relevant to mitigation in her pleading or to present those facts in her case in chief, but she would do so in anticipation of the employer's affirmative defense, not as a legal requirement.

We agree with the Third Circuit that the case, in its current posture, presents genuine issues of material fact concerning Suders' hostile work environment and constructive discharge claims. We hold, however, that the

Court of Appeals erred in declaring the affirmative defense described in *Ellerth* and *Faragher* never available in constructive discharge cases. Accordingly, we vacate the Third Circuit's judgment and remand the case for further proceedings consistent with this opinion.

It is so ordered.

DISSENT

Justice Thomas, dissenting

. . . [T]he National Labor Relations Board (NLRB) developed the concept of constructive discharge to address situations in which employers coerced employees into resigning because of the employees' involvement in union activities. In light of this specific focus, the NLRB requires employees to establish two elements to prove a constructive discharge. First, the employer must impose burdens upon the employee that "cause, and [are] intended to cause, a change in his working conditions so difficult or unpleasant as to force him to resign. Second, it must be shown that those burdens were imposed because of the employee's union activities."

When the constructive discharge concept was first imported into Title VII of the Civil Rights Act of 1964, some courts imposed similar requirements. Moreover, because the Court had not yet recognized the hostile work environment cause of action, the first successful Title VII constructive discharge claims typically involved adverse employment actions. If, in order to establish a constructive discharge, an employee must prove that his employer subjected him to an adverse employment action with the specific intent of forcing the employee to quit, it makes sense to attach the same legal consequences to a constructive discharge as to an actual discharge.

The Court has now adopted a definition of constructive discharge, however, that does not in the least resemble actual discharge. The Court holds that to establish "constructive discharge," a plaintiff must "show that the abusive working environment became so intolerable that [the employee's] resignation qualified as a fitting response." Under this rule, it is possible to allege a constructive discharge absent any adverse employment action. Moreover, a majority of Courts of Appeals have declined to impose a specific intent or reasonable foreseeability requirement.

Thus, as it is currently conceived, a "constructive" discharge does not require a "company act[] that can be performed only by the exercise of specific authority granted by the employer," nor does it require that the act be undertaken with the same purpose as an actual discharge. Under these circumstances, it no longer makes sense to view a constructive discharge as equivalent to an actual discharge. Instead, as the Court points out, a constructive discharge is more akin to "an aggravated case of . . . sexual harassment or hostile work environment." And under this "hostile work environment plus" framework, the proper standard for determining employer liability is the same standard for hostile work environment claims that I articulated in *Burlington Industries., Inc.* "An employer should be liable if, and only if, the plaintiff proves that the employer was negligent in permitting the supervisor's conduct to occur." If a supervisor takes an adverse employment action because of sex that directly results in the constructive discharge, the employer is vicariously liable. But, where the alleged constructive discharge results only from a hostile work environment, an employer is liable if negligent. Because respondent has not adduced sufficient evidence of an adverse employment action taken because of her sex, nor has she proffered any evidence that petitioner knew or should have known of the alleged harassment, I would reverse the judgment of the Court of Appeals.

Case Questions

1. Do you agree with Justice Thomas' dissenting assessment of the distinction between proving constructive discharge and proving actual discharge?
2. Do you agree that an adverse employment action is so critical to a claim of constructive discharge?
3. What do you expect to be the enduring impact of this decision?

Retaliatory Discharge

Retaliatory discharge is another constraint on employment at-will. Though discharge in retaliation for exercising specific rights was discussed previously in this chapter in connection with public policy, it will also be addressed in later chapters with regard to discharges in connection with various specific statutes, such as termination for filing an ADA complaint, ADEA complaint, or other charge with the EEOC. Title VII specifically

prohibits adverse employment actions based on the fact that an employee or former employee has "made a charge, testified, assisted or participated in any manner in an investigation, proceeding or hearing under this [Act]." Note that retaliatory discharge claims are somewhat distinct from discharge based on whistle-blowing (even though the discharge might be in retaliation for the whistle-blowing) since the former is prohibited by Title VII while employees are protected from the latter by a number of different statutes. Since retaliatory discharge claims can be brought based simply on one's participation in a protected activity such as a colleague's Title VII complaint or one's opposition to a wrongful employer practice, it is not necessary for the claimant to actually be a member of a protected group or to have suffered discrimination herself.

The prima facie case for retaliatory discharge includes evidence of

1. Protected activity—opposition to discrimination or participation in the statutory complaint process.
2. Adverse action.
3. Causal connection between the protected activity and the adverse action.[13]

To determine whether the employee has satisfied the prima facie case, the EEOC's compliance manual suggests the following questions:[14]

1. Did the charging party (CP/employee) oppose discrimination?
   a. Did the charging party explicitly or implicitly communicate to the respondent (R/employer) or another covered entity a belief that its activity constituted unlawful discrimination under Title VII, the ADA, the ADEA, or the EPA?
      i. If the protest was broad or ambiguous, would CP's protest reasonably have been interpreted as opposition to such unlawful discrimination?
      ii. Did someone closely associated with CP oppose discrimination?
   b. Was the manner of opposition reasonable? Was the manner of opposition so disruptive that it significantly interfered with R's legitimate business concerns?
      i. If the manner of opposition was not reasonable, CP is not protected under the antiretaliation clauses.
   c. Did CP have a reasonable and good faith belief that the opposed practice violated the antidiscrimination laws?
      i. If so, CP is protected against retaliation, even if s/he was mistaken about the unlawfulness of the challenged practices.
      ii. If not, CP is not protected under the antiretaliation clauses.
2. Did CP participate in the statutory complaint process?
   a. Did CP or someone closely associated with CP file a charge, or testify, assist, or participate in any manner in an investigation, proceeding, hearing, or lawsuit under the statutes enforced by the EEOC?
      i. If so, CP is protected against retaliation regardless of the validity or reasonableness of the original allegation of discrimination.
      ii. CP is protected against retaliation by a respondent for participating in statutory complaint proceedings even if that complaint involved a different covered entity.

[13] EEOC Compliance Manual, "Guidance and Instructions for Investigating and Analyzing Claims of Retaliation," http://www.eeoc.gov/policy/docs/retal.html (5/20/98).

[14] Ibid.

3. Did R subject CP to any kind of adverse treatment?
   a. Adverse actions undertaken after CP's employment relationship with R ended, such as negative job references, can be challenged.
   b. Although trivial annoyances are not actionable, more significant retaliatory treatment that is reasonably likely to deter protected activity is unlawful. There is no requirement that the adverse action materially affect the terms, conditions, or privileges of employment.
4. Causal connection—Is there direct evidence that retaliation was a motive for the adverse action?
   a. Did R official admit that it undertook the adverse action because of the protected activity?
   b. Did R official express bias against CP based on the protected activity? If so, is there evidence linking that statement of bias to the adverse action?
   c. Such a link would be established if, for example, the statement was made by the decision maker at the time of the challenged action.
   d. If there is direct evidence that retaliation was a motive for the adverse action, "cause" should be found. Evidence as to any additional legitimate motive would be relevant only to relief, under a mixed-motives analysis.
5. Is there circumstantial evidence that retaliation was the true reason for the adverse action?
   a. Is there evidence raising an inference that retaliation was the cause of the adverse action?
      i. Such an inference is raised if the adverse action took place shortly after the protected activity and if the decision maker was aware of the protected activity before undertaking the adverse action.
      ii. If there was a long period of time between the protected activity and the adverse action, determine whether there is other evidence raising an inference that the cause of the adverse action was retaliation.
   b. Has R produced evidence of a legitimate, nondiscriminatory reason for the adverse action?
   c. Is R's explanation a pretext designed to hide retaliation?
      i. Did R treat similarly situated employees who did not engage in protected activity differently from CP?
      ii. Did R subject CP to heightened scrutiny after she or he engaged in protected activity?
      iii. If, on the basis of all of the evidence, the investigator is persuaded that retaliation was the true reason for the adverse action, then "cause" should be found.[15]

EEOC guidance expands the interpretation of this provision, explaining that an adverse employment action need not actually be termination, nor must it materially affect the terms, conditions, or privileges of the employment relationship. In fact, an employee is still protected even if he or she participates in an investigation that eventually uncovers no wrongdoing. However, where an employee merely protests or opposes illegal

[15] Ibid. (adapted).

discrimination and does not file a formal charge, the worker is afforded slightly less protection. To be covered, the worker must have a reasonable belief in the illegality of the practice. A belief that wouldn't be held by another reasonable person could preclude a plaintiff's claim. For instance, in *Clark County School District* v. *Breeden,* 85 FEP Cases 730 (2001), the Supreme Court held that a plaintiff's belief that she was protesting unlawful sexual harassment was not reasonable. "No one could reasonably believe that this incident [alleged by the plaintiff] violated Title VII."

Courts are sensitive to claims of retaliation in order to protect an employee's right to protest wrongful employment or other actions. If workers were not protected against retaliation, there would be a strong deterrent to asserting one's rights. On the other hand, if the employer's action is legitimately based in law or on legitimate, nondiscriminatory reason (LNDR), the employer's actions are protected.[16] EEOC guidance recommends that evidence of retaliation is sufficient to support a claim as long as it played any role in the employer's decision. The courts, however, don't necessarily agree, concluding instead that an employer's decision is insulated if it would have made the same decision notwithstanding the retaliatory motive.[17]

Constitutional Protections

Though perhaps it goes without saying, under certain circumstances an employer may not take an adverse employment action against a worker for exercising constitutional rights. However, this applies only where the employer is a public entity since constitutional rights exist against state action rather than action by private employers. For instance, a public employer may not terminate a worker for the exercise of free speech (including whistle-blowing under most circumstances) or based on a particular political affiliation. These same protections may apply in connection with private employers where the adverse actions violate some recognized expression of public policy, even without state action. Examples of this application include protection of an employee who refused to participate in an employer's public lobbying campaign but no protection for an employee who chooses to become a candidate in a campaign.

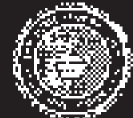
Military Leave

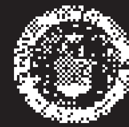
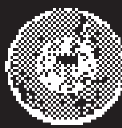
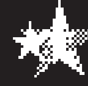
Under the Uniformed Services Employment and Reemployment Rights Act (USERRA), workers who enter military service and receive an honorable discharge are guaranteed reemployment protected against discrimination and retaliation on the basis of their service or time in service (see Exhibit 1.7). USERRA provides protection to all workers who perform service in the uniformed services. Though the act specifically does not apply to temporary workers, it does apply to anyone with a realistic expectation of ongoing employment such as a seasonal worker who returns on a recurring basis or part-time workers who work on a continued basis. The service covered may be voluntary or conscripted and any type of duty, including training and/or examinations.

To take advantage of USERRA, an employee must provide advance written or verbal notice to the employer (unless is unreasonable or unable to do so by military necessity),

[16] *Sahli* v. *Bull HN Information Systems Inc.,* No. SJC-08697 (Mass. D.Ct. 2002).

[17] *McNutt* v. *Board of Trustees of the University of Illinois,* 76 FEP Cases 989 (7th Cir. 1998).



YOUR RIGHTS UNDER USERRA

THE UNIFORMED SERVICES EMPLOYMENT AND REEMPLOYMENT RIGHTS ACT

USERRA protects the job rights of individuals who voluntarily or involuntarily leave employment positions to undertake military service. USERRA also prohibits employers from discriminating against past and present members of the uniformed services, and applicants to the uniformed services.

REEMPLOYMENT RIGHTS

[illegible]

RIGHT TO BE FREE FROM DISCRIMINATION AND RETALIATION

[illegible]

HEALTH INSURANCE PROTECTION

[illegible]

ENFORCEMENT

[illegible]

[illegible]

U.S. Department of Labor
1-866-487-2365

1-800-336-4590

[illegible]

must take a leave from this particular employer of no more than a cumulative of five years, and must submit an application for reemployment within the required time period (which depends on the length of the individual's service). If these requisites are satisfied, the employee must be allowed to return to the position in which she or he would have found themselves if they had remained with the employer, or a position of equivalent rank, pay, and seniority. However, an employer is relieved of the obligation to reemploy under USERRA if its circumstances have changed so reemployment is impossible (such as a reduction in force that eliminated the position), or if it would impose an undue burden on the employer (such as the case of a returning worker disabled in service who cannot be reasonably accommodated; see Chapter 12).

An employer is not required to pay the worker during the leave unless, of course, the worker chooses to use accrued allowable paid leave (though they are not required to use that leave). The act also contains provisions for the continuation of medical coverage and pension benefits (for which military leave constitutes standard work time with the employer).

Wrongful Discharge Based on Other Tort Liability

A *tort* is a violation of a duty, other than one owed when the parties have a contract. Where a termination happens because of intentional and outrageous conduct on the part of the employer and causes emotional distress to the employee, the employee may have a tort claim for a wrongful discharge in approximately half of the United States. For example, in one case, an employee was terminated because she was having a relationship with a competitor's employee. The court determined that forcing the employee to choose between her position at the company and her relationship with a male companion constituted outrageous conduct.

One problem exists in connection with a claim for physical or emotional damages under tort theories. In many states, an employee's damages are limited by workers' compensation laws. Where an injury is work related, such as emotional distress as a result of discharge, these statutes provide that the workers' compensation process is a worker's exclusive remedy. An exception exists where a claim of injury is based solely on emotional distress; in that situation, many times workers' compensation will be denied. Therefore, in those cases, the employee may proceed against the employer under a tort claim. To avoid liability for this tort, the employer should ensure that the process by which an employee is terminated is respectful of the employee as well as mindful of the interests of the employer.

Where a discharge acts to defame the employee, there may be sufficient basis for a tort action for defamation. To sustain a claim for defamation, the employee must be able to show that (1) the employer made a false and defamatory statement about the employee, (2) the statement was communicated to a third party without the employee's consent, and (3) the communication caused harm to the employee. Claims of defamation usually arise where an employer makes statements about the employee to other employees or her or his prospective employers. This issue is covered in Chapter 13 relating to the employee's privacy rights and employer references.

Finally, where the termination results from a wrongful invasion of privacy, an employee may collect damages. For instance, where the employer wrongfully invades the employee's privacy, searches her purse, and consequently terminates her, the termination may be wrongful.

Management Tips

- No matter the size of your organization, as long as you have hired one individual to work for you, you are considered an employer and potentially subject to numerous federal and other regulations, as well as to wrongful termination liability.
- You are always allowed to hire the best person for a job; the law merely states that you may not make this decision based on prejudice or stereotypes. In order to avoid a wrongful discharge suit and, more importantly, to ensure the ethical quality of your decisions, don't fire someone for some reason that violates basic principles of dignity, respect, or social justice.
- You have the right to fire an employee for *any* reason as long as it is not for one of the specific reasons prohibited by law. On the other hand, if you don't have sufficient documentation or other evidence of the appropriate reason for your decision, a court might infer that your basis is wrongful.
- While it is inconvenient, to say the least, when an employee reports wrongdoing occurring at your firm, under most circumstances, you may not retaliate against that person. Be sure to avoid even the *appearance* of retaliation, as the actual motivation for employment decisions is often difficult to prove.
- Since statements in an employment policy manual may be construed in some circumstances as contractual promises, review all documentation *as if* you will be bound to it as a contract.
- Have sufficient training for all employees who will conduct interviews, since the firm may be bound by promises made to applicants during interviews if the applicant relies on the promise in accepting a position.
- Review arbitration agreements to ensure fairness.
- Review noncompete agreements, if valid and enforceable under applicable state law, to ensure that the restrictions placed on employees are reasonable.
- Have termination decisions be subject to internal review. Unilateral decisions to fire an employee may lead to emotion rather than reason being used to determine terminations.
- In the event of a layoff:

— Clearly explain to employees the reasons for the actions taken: Document all efforts to communicate with employees.

— Prepare the managers who will deliver the message.

— Speak plainly and don't make promises.

— Avoid euphemisms such as "We are all family and we will be together again someday."

— Emphasize that it's not personal.

— Know how layoffs will affect the demographic breakdown of the staff.*

*Matthew Boyle, "The Not-So-Fine Art of the Layoff," *Fortune,* Mar. 19, 2001, pp. 209–210.

THE "FREEDOM" TO CONTRACT IN THE REGULATORY EMPLOYMENT ENVIRONMENT

In the age of increasingly complex regulations governing the workplace, the relationship between employer and employee is still essentially contractual. As you have seen throughout this chapter, terms and conditions of employment may be expressed or implied. Though an employer is generally free to design contract terms of any kind, the terms and conditions set by an employer cannot violate the letter or the spirit of applicable laws. In addition, courts and legislatures may determine that certain types of

agreements between employer and employee are unenforceable, given other competing interests at stake. The focus of this chapter, therefore, is the manner in which the employment relationship is regulated in general. These regulations, as mentioned, tend to restrict what an employer can do. Accordingly, though this is the first chapter in the text, you will find discussions throughout with regard to all employment decisions, including terminations.

Covenants Not to Compete ("Noncompete Agreements")

One employment constraint that has received varying degrees of acceptance by different states is the so-called noncompete agreement. While individuals in positions of trust and confidence already owe a duty of loyalty to their employers during employment, even without a noncompete agreement, a **noncompete agreement** usually requires that the employee not disclose trade secrets, solicit other employees or customers, or enter into competition with the employer upon termination of the employment relationship. All states allow employers to control what information a former worker can use or disclose in a competing business and whether a former worker can encourage clients, customers, and former co-workers to leave the employer.

noncompete agreement
An agreement signed by the employee agreeing not to disclose the employer's confidential information or enter into competition with the employer for a specified period of time and/or within a specified region.

However, not all states allow employers to prevent former workers from competing with them. These covenants are specifically permitted in Hawaii, South Dakota, Texas, and Wisconsin. In Nevada, Montana, North Dakota, and Oklahoma, an agreement limiting for whom a former employee can work and where he or she can work will not be enforced. In several other states, such as Alabama, Colorado, Florida, Oregon, Louisiana, California, and Texas, an employer may only keep a worker from competing under certain circumstances. For example, in Colorado, "management personnel" may have noncompete agreements enforced against them while others may not. In all other states, an employer may restrict where, when, and what type of work an employee may engage in at the end of the employment relationship, as long as the restrictions are reasonable.[18]

But what are "reasonable" restrictions on an employee's ability to enter into competition with the employer after the employment relationship has ended? The Restatement (Second) of Contracts explains that common law generally prohibits the restriction "if it is greater than necessary to protect the employer's legitimate interests or if the promisee's need is outweighed by the hardship to the promisor and likely injury to the public." In determining what is reasonable, courts look to the geographical and time limitations placed on the employee's ability to engage in competition. The definition of "competition" under the noncompete agreement is also relevant: Is the employee prohibited from working in any capacity with a competitor or merely restricted from entering into direct competition with the employer? Restrictions that are for an indefinite period of time, or that prohibit the employee from working "anywhere in the United States," may be considered unreasonable. However, as an example, restricting an employee from engaging in direct competition with the employer for one year from the end of their employment relationship within the same county may be considered reasonable. Generally, in order to be

[18] Shannon Miehe, *How to Create a Noncompete Agreement* (Berkeley, CA: Nolo Press, 2001), pp. 1/3, 1/4.

considered reasonable, the restrictive covenant should not prevent the employee from earning a living of any sort under its terms.

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

1. It protects a legitimate business interest.
2. It is ancillary to a legitimate business relationship.
3. It provides a benefit to both the employee and employer.
4. It is reasonable in scope and duration.
5. It is not contrary to the public interest.[19]

In *EarthWeb* v. *Schlack*,[20] a federal judge was asked to enforce a covenant not to compete that would have prohibited a Web site content manager from working for a new employer in "direct competition" with EarthWeb for one year. The new employer, International Data Group, planned to launch a Web site, Itworld.com. The judge considered one year in "Internet time" to be too burdensome. In arriving at this conclusion, the judge assessed the characteristics of the Internet industry, which is dynamic, constantly evolving, and lacking geographical borders. Further, Schlack's former position with EarthWeb was "cutting-edge" and "depended on keeping abreast of the daily changes in content on the Internet."

A lesson learned from *EarthWeb* applies to all employers considering the use of noncompete agreements: Reasonableness is measured by the realities of the industry and the nature of the employee's occupation.

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

The Uniform Trade Secrets Act is a model act that 45 states have adopted. It provides relief in the form of monetary damages, attorney's fees, and injunctive relief for misappropriation of trade secrets and includes a provision for "inevitable disclosure." Under this doctrine, courts have found that employees may be in violation of a confidentiality agreement if they accept a new position with a different employer that will necessarily require the employee to divulge or otherwise use the prior employer's trade secrets.

[19] W. Martucci and J. Place, "Covenants Not to Compete," *Employment Relations Today* 21 (1998), pp. 77–83.

[20] 171 F. Supp. 2d 299 (S.D.N.Y. 1999).

Keeping Trade Secrets "Secret"[1]

An essential element in obtaining relief under the Uniform Trade Secrets Act is to show that the trade secret is, in fact, treated as secret—that is, that the company that owns the trade secret takes reasonable precautions to prevent disclosure to anyone other than an intended recipient. In making this determination, courts look to a number of factors. A company wishing to maintain its trade secrets as "secret" should consider these same factors. The following checklist, although not all-inclusive, provides guidance on maintaining the secret status of trade secrets:

TRADE SECRET CHECKLIST

- Are employees and third parties with access to trade secrets required to sign confidentiality agreements?
- Are employees and third parties with access to trade secrets alerted to their confidential and proprietary nature, for example, through personnel manuals, reminder memoranda, posted warnings, appropriate labels on the data, and the like?
- Is sensitive data kept under lock and key?
- Is access to sensitive data limited to those with a particular need for the information?
- Is the information maintained in an area with a photocopying machine?
- Are documents containing sensitive data kept by people at their own desks? If so, is it necessary?
- Are desks containing sensitive data locked and is access limited only to those with need to that data?
- Is the data marked plainly and obviously as "Secret," "Confidential," "Restricted Access," or with a similar identifier? If documents containing confidential or trade secret data must be shared with third parties, do you have comprehensive, written confidentiality agreements with those third parties and provisions that such data is to be returned or destroyed once there is no further need for the data?
- If confidential documents are given to certain employees, are they serially numbered? Is a log of such documents kept by a company official?
- Are the documents containing confidential data ever left unattended on desks or in a lunchroom or conference room where personnel unauthorized to see such information could come in contact with the documents?
- Are visitors, guests, and nonessential personnel restricted from areas in which secret processes or machines are developed, operated, or displayed in a way that could be considered revealing to a knowledgeable observer?
- Are visitors and guests allowed to visit factories or facilities where secret processes or machines are in use or operation?
- Is there a company policy limiting or prohibiting the use of cameras by visitors?
- Are all visitors, including suppliers, vendors, and maintenance persons, required to sign in, state the nature of their visit, indicate with whom they are visiting, and sign out?
- Are special internal procedures in place to verify the service calls of repair and service personnel including verifying the service person's credentials and the purpose of the visit?
- Are doors and entryways leading to areas where secret processes are maintained or performed or where machinery is operated kept locked?
- Are keys issued only to those employees who need them?
- If security and alarm systems are required to protect a secret process effectively, are they installed?
- Are security guards used when necessary?
- Are all document control systems, such as those described above, periodically reviewed and revised?
- Is disclosure of a substantial portion of trade secret information through display, publication, or advertising prohibited?
- Are employees instructed not to discuss secret company projects in the presence of visitors, especially suppliers and vendors?
- Are federal copyright laws used to protect documents?

COMMENT

As a final point, courts will generally help those who can demonstrate that they have acted prudently to protect themselves. Be ready to show the efforts and especially the money used to produce trade secrets and the steps taken to preserve their secrecy.

[1] Reprinted with permission from Smith, Currie & Hancock, LLP, http://www.smithcurrie.com/fall-2003-7.htm.

Arbitration Agreements in Employment Contracts

Another covenant included in some employment contracts today is an agreement regarding arbitration. A *typical arbitration agreement* provides that "any dispute or claim concerning Employee's employment with [Employer] or the terms, conditions, or benefits of such employment, will be settled by binding arbitration." This agreement is usually entered into at the beginning of the employment relationship or as part of the preemployment process. **Arbitration** involves selecting a neutral party to consider evidence and arguments presented by the parties and arriving at a decision. Under "binding" arbitration, the parties are held to the decision of the arbitrator and cannot file a lawsuit in court.

arbitration
The selection of a neutral or third party to consider a dispute and to deliver a binding or nonbinding decision.

As a form of alternate dispute resolution (ADR), arbitration serves as an efficient mechanism for avoiding lengthy and costly litigation. Further, it may avoid the embarrassment potentially generated by a public proceeding. These advantages to arbitration in business are reflected in a federal policy strongly favoring this form of dispute resolution. The Federal Arbitration Act of 1925 (FAA) declared that arbitration provisions in contracts involving commerce "shall be valid, irrevocable, and enforceable," unless the contract is invalid for other reasons applicable to any kind of contract. State statutes, such as the California Arbitration Act (CAA), codified the strong policy favoring resolution of commercial disputes with arbitration.

Whether the FAA applied to employment contracts was a question left to the federal courts. In *Circuit City Stores, Inc.* v. *Adams,*[21] the U.S. Supreme Court considered an arbitration agreement entered into by Adams in an employment application with Circuit City in 1995 in Santa Rosa, California. In 1997, Adams filed an employment discrimination lawsuit against Circuit City in state court, alleging that he had resigned as a sales counselor because he was subjected to sexual orientation harassment by coworkers and a manager in violation of California law. Circuit City asked a federal court to enforce the arbitration agreement pursuant to the FAA. The Court held that employment arbitration agreements, except for those covering workers engaged in transportation, are covered by the FAA.

Questions still remain about the enforceability of arbitration agreements: Can employers enforce arbitration agreements that place an undue burden on employees seeking to vindicate their rights, such as requiring them to pay all arbitration costs? Also, may an administrative agency such as the Equal Employment Opportunity Commission, which enforces federal antidiscrimination protections, exercise its power to seek judicial relief on behalf of an employee who has signed an arbitration agreement?

The answer to the second question was given by the U.S. Supreme Court in *EEOC* v. *Waffle House.*[22] In his application for employment with Waffle House, Eric Baker entered into an arbitration agreement with the prospective employer. After he began working as a grill operator at a South Carolina Waffle House, Baker suffered a seizure at work and was soon discharged. He filed a charge of discrimination against his former employer with the EEOC. The EEOC filed an enforcement action against Waffle House in federal court on Baker's behalf, seeking compensatory and punitive damages.

[21] 532 U.S. 105 (2001).

[22] 122 S. Ct. 754 (2002)..

The EEOC also sought an order to stop Waffle House from continuing its unlawful employment practices.

The U.S. Supreme Court considered whether the arbitration agreement that Baker had entered into with Waffle House barred the EEOC from intervening in this manner. The Court held that the EEOC was not barred by the arbitration agreement, as it was not a party to the agreement. Therefore, public agencies are not limited by the existence of an arbitration agreement between employers and employees.

Courts have struggled with the issue of fairness in deciding whether certain mandatory arbitration agreements are enforceable against employees seeking to vindicate their rights. Employees may not understand what they have agreed to, or they may understand but feel they have no choice but to agree. Court are concerned in part because the rights that an employee gives up are so critical to fairness—a jury trial, full discovery, judicial review, and certain statutory remedies, among others. In *Armendariz* v. *Foundation Health Psychcare Services, Inc.,*[23] the California Supreme Court set forth minimum requirements for enforcement of a mandatory employment arbitration agreement:

1. The agreement cannot exclude relief that would otherwise be available in court (e.g., punitive damages).
2. The parties must be allowed to conduct discovery sufficient to allow them to adequately arbitrate claims.
3. Employers cannot require employees to pay unreasonable costs or arbitrator's fees, as this unduly adds to the burden of bringing a claim.
4. The arbitrator must be neutral and issue a written award.
5. The arbitration agreement must be mutual: Employers should also be bound to arbitration of employment-related disputes.

In *Labor Ready Central* v. *Gonzalez,*[24] a state appellate court in Texas concluded that an employment arbitration agreement was not enforceable because the employer was not required to arbitrate claims it may assert against Gonzalez. The lack of mutuality of obligation made the agreement unenforceable.

Thus, express agreements entered into between employers and employees may still be subject to regulatory and judicial oversight to ensure fairness and equity in the employment relationship.

MANAGEMENT CONSIDERATIONS

For reasons cited earlier in this chapter, an employer may hire someone with the intent of establishing an employment relationship or an independent-contractor relationship. A variety of protections available to the employer allows the employer some measure of control over this seemingly arbitrary categorization process. However, none will guarantee a court determination of employee or independent-contractor status.

[23] 24 Cal. 4th 83 (2000).

[24] 2001 Tex. App. LEXIS 7995 (Tex. App. 2001).

Management Tips

- Always evaluate the status of your workers; don't assume employee or independent-contractor status for any worker.
- Employment status is relevant to employer payroll and other financial issues; therefore, misclassification may be costly to the employer.
- While an employer is not liable to independent contractors for discrimination based on Title VII, the independent contractor may have other causes of action. Therefore, hiring an independent contractor is not a safe harbor from liability.
- If your intent is to hire an individual as an independent contractor, ensure that, among other factors, the worker has complete control over the manner in which the work will be done, uses her or his own supplies, is paid by the project rather than by the hour, and sets her or his own hours to complete the project.
- Monitor staffing firms with which you contract for temporary or other contingent workers to ensure that the workers are being properly paid and that the firm provides workers' compensation coverage.[1]

[1] See Kenneth J. Turnbull, "Using Contingent Workers Can Create Complications," *New York Law Journal*, Jan. 12, 2001.

First, as in most relationships, a written document will help to identify the nature of the association between the parties and their rights and obligations, provided that the role of the worker is consistent with the duties of an employee or independent contractor. While the classification made in this document is not binding in any way on the courts or the IRS, it may serve as persuasive evidence about the parties' intentions.

If the person is hired as an employee, and it is so stipulated in the document, the written agreement may be considered an employment agreement. The employer should be careful to discuss whether the employment duration will remain at will or for a specified time period.

If the employer intends to hire the worker as an independent contractor, the agreement should articulate the extent of the worker's control over her or his performance and the outcome to be produced pursuant to the contract. Further, where the agreement recites particular hours to be worked, rather than a deadline for completion, it is more likely that the worker will be considered an employee.

Included in the written agreement should be a discussion of who is responsible for the payment of income taxes and benefits and for the division of responsibility for office expenses and overhead, such as tools, supplies, and office rent.

Second, the independent contractor should be paid on the basis of the nature of the job completed, rather than the hours worked to complete it.

Third, no training should be offered to an independent contractor; courts hypothesize that the reason an employer would hire outside help is to reduce these costs. On the other hand, where an employer provides extensive training and support, it is likely that the employer seeks to reap a benefit from this investment in the long run through continued service of its employee.

Fourth, where additional assistance is required, an independent contractor will be made to supply that extra assistance, while an employer would be the party to provide the aid if the worker is an employee. The employer may offer to guarantee a loan to the contractor to allow her or him to obtain the assistance, or new tools, or other equipment if necessary without threatening the independent-contractor status.

Finally, where the risk of misclassification is great—for instance, where the failure to correctly categorize the worker may result in large financial penalties—the employer may choose to obtain an advance ruling from the IRS regarding the nature of the relationship. This is accomplished through the filing of IRS Form SS-8 (see Exhibit 1.8).

Given the possibility of unlimited compensatory and punitive damage awards in wrongful discharge actions, employers are cautioned regarding their interpretation and implementation of the at-will employment arrangement. Employees' protections from unjust dismissal are not limited to statutes prohibiting employment discrimination based on certain factors. Increasingly, employees are able to rely on promises made by the employer through, for example, the employment policy manual. Further, public policy considerations beyond antidiscrimination protections also place limits on the manner in which an employer may terminate an employment relationship. An employer is prohibited from acting in a manner that undermines public policy, however defined.

When an employee is terminated for exercising a protected right, for performing a public duty, for refusing to commit a crime or an immoral or unethical act, or for exposing the employer's or a co-worker's wrongdoings, the termination may be wrongful, and the employer may be liable for the payment of economic damages, as well as compensation for emotional distress and suffering.

In order to limit liability for wrongful termination, employers should strive to make honesty and fairness core values of the organization that are reflected in their employment practices. Employees' exercise of their protected rights and performance of their public duties should be supported but employers should inform workers pre-employment that employment is at-will, if applicable. Evaluations should be forthcoming in good-faith critique related to job performance. Overstatements regarding the employee's prospects for advancement, perhaps made to maintain employee retention, should be avoided. False information about the health and future of the organization should also not be made, even if for the purpose of heightening employee morale. Arbitration and noncompete agreements should conform with legal requirements for enforceability and should enter the employment relationship only as good-faith measures to further the organization's risk management efforts.

Be careful of statements made to interviewees regarding promises of why an employee will be dismissed or regarding salary or permanent status. Ensure that contracts for dismissed employees cannot be implied from acts the employer has done, like setting up the expectation of permanent employment by longevity, consistently great evaluation, and the like. It may mean, for the employer, that the employer has even less flexibility than desirable in this area. However, the employer's ability to control is most conclusive in determining liability.

Form **SS-8**
(Rev. June 2003)
Department of the Treasury
Internal Revenue Service

Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding

OMB No. 1545-0004

Name of firm (or person) for whom the worker performed services	Worker's name	
Firm's address (include street address, apt. or suite no., city, state, and ZIP code)	Worker's address (include street address, apt. or suite no., city, state, and ZIP code)	
Trade name	Telephone number (include area code)	Worker's social security number
Telephone number (include area code) / Firm's employer identification number	Worker's employer identification number (if any)	

If the worker is paid by a firm other than the one listed on this form for these services, enter the name, address, and employer identification number of the payer.

Important Information Needed To Process Your Request

We must have your permission to disclose your name and the information on this form and any attachments to other parties involved with this request. Do we have your permission to disclose this information? . . . . ☐ Yes ☐ No
If you answered "No" or did not mark a box, we will not process your request and will not issue a determination.

You must answer ALL items OR mark them "Unknown" or "Does not apply." If you need more space, attach another sheet.

A This form is being completed by: ☐ Firm ☐ Worker; for services performed ______________ to ______________ .
(beginning date) (ending date)

B Explain your reason(s) for filing this form (e.g., you received a bill from the IRS, you believe you erroneously received a Form 1099 or Form W-2, you are unable to get worker's compensation benefits, you were audited or are being audited by the IRS).
....
....

C Total number of workers who performed or are performing the same or similar services ______________ .

D How did the worker obtain the job? ☐ Application ☐ Bid ☐ Employment Agency ☐ Other (specify) ______________

E Attach copies of all supporting documentation (contracts, invoices, memos, Forms W-2 or Forms 1099-MISC issued or received, IRS closing agreements, IRS rulings, etc.). In addition, please inform us of any current or past litigation concerning the worker's status. If no income reporting forms (Form 1099-MISC or W-2) were furnished to the worker, enter the amount of income earned for the year(s) at issue $ ______________

F Describe the firm's business. ....
....
....

G Describe the work done by the worker and provide the worker's job title.
....
....

H Explain why you believe the worker is an employee or an independent contractor. ....
....

I Did the worker perform services for the firm before getting this position? . . . . ☐ Yes ☐ No ☐ N/A
If "Yes," what were the dates of the prior service? ....
If "Yes," explain the differences, if any, between the current and prior service. ....
....
....

J If the work is done under a written agreement between the firm and the worker, attach a copy (preferably signed by both parties). Describe the terms and conditions of the work arrangement.
....

For Privacy Act and Paperwork Reduction Act Notice, see page 5. Cat. No. 16106T Form **SS-8** (Rev. 6-2003)

Exhibit 1.8 (continued)

Part I Behavioral Control

1 What specific training and/or instruction is the worker given by the firm?

2 How does the worker receive work assignments?

3 Who determines the methods by which the assignments are performed?

4 Who is the worker required to contact if problems or complaints arise and who is responsible for their resolution?

5 What types of reports are required from the worker? Attach examples.

6 Describe the worker's daily routine (i.e., schedule, hours, etc.).

7 At what location(s) does the worker perform services (e.g., firm's premises, own shop or office, home, customer's location, etc.)?

8 Describe any meetings the worker is required to attend and any penalties for not attending (e.g., sales meetings, monthly meetings, staff meetings, etc.).

9 Is the worker required to provide the services personally? ☐ Yes ☐ No

10 If substitutes or helpers are needed, who hires them?

11 If the worker hires the substitutes or helpers, is approval required? ☐ Yes ☐ No

If "Yes," by whom?

12 Who pays the substitutes or helpers?

13 Is the worker reimbursed if the worker pays the substitutes or helpers? ☐ Yes ☐ No

If "Yes," by whom?

Part II Financial Control

1 List the supplies, equipment, materials, and property provided by each party:

The firm

The worker

Other party

2 Does the worker lease equipment? ☐ Yes ☐ No

If "Yes," what are the terms of the lease? (Attach a copy or explanatory statement.)

3 What expenses are incurred by the worker in the performance of services for the firm?

4 Specify which, if any, expenses are reimbursed by:

The firm

Other party

5 Type of pay the worker receives: ☐ Salary ☐ Commission ☐ Hourly Wage ☐ Piece Work

☐ Lump Sum ☐ Other (specify)

If type of pay is commission, and the firm guarantees a minimum amount of pay, specify amount $

... drawing account for advances? ☐ Yes ☐ No 6 ... the worker ...

...ation? ... If "Yes," how o...

...solutions. ... Specify any res...

...e customer pay? ☐ Firm ☐ Worker 7 Whom does th...

...the worker pay the total amount to the firm? ☐ Yes ☐ No If "No," explain ... worker. Does ...

...any workers' compensation insurance on the worker? ☐ Yes ☐ No 8 Does the firm c...

...of loss or financial risk, if any, can the worker incur beyond the normal loss of salary (e.g., loss or damage of equipment, 9 What economic ... etc.)?

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Part III Relationship of the Worker and Firm

1 List the benefits available to the worker (e.g., paid vacations, sick pay, pensions, bonuses).

2 Can the relationship be terminated by either party without incurring liability or penalty? ☐ Yes ☐ No
If "No," explain your answer.

3 Does the worker perform similar services for others? ☐ Yes ☐ No
If "Yes," is the worker required to get approval from the firm? ☐ Yes ☐ No

4 Describe any agreements prohibiting competition between the worker and the firm while the worker is performing services or during any later period. Attach any available documentation.

5 Is the worker a member of a union? ☐ Yes ☐ No

6 What type of advertising, if any, does the worker do (e.g., a business listing in a directory, business cards, etc.)? Provide copies, if applicable.

7 If the worker assembles or processes a product at home, who provides the materials and instructions or pattern?

8 What does the worker do with the finished product (e.g., return it to the firm, provide it to another party, or sell it)?

9 How does the firm represent the worker to its customers (e.g., employee, partner, representative, or contractor)?

10 If the worker no longer performs services for the firm, how did the relationship end?

Part IV For Service Providers or Salespersons—Complete this part if the worker provided a service directly to customers or is a salesperson.

1 What are the worker's responsibilities in soliciting new customers?

2 Who provides the worker with leads to prospective customers?

3 Describe any reporting requirements pertaining to the leads.

4 What terms and conditions of sale, if any, are required by the firm?

5 Are orders submitted to and subject to approval by the firm? ☐ Yes ☐ No

6 Who determines the worker's territory?

7 Did the worker pay for the privilege of serving customers on the route or in the territory? ☐ Yes ☐ No
If "Yes," whom did the worker pay?
If "Yes," how much did the worker pay? $

8 Where does the worker sell the product (e.g., in a home, retail establishment, etc.)?

9 List the product and/or services distributed by the worker (e.g., meat, vegetables, fruit, bakery products, beverages, or laundry or dry cleaning services). If more than one type of product and/or service is distributed, specify the principal one.

10 Does the worker sell life insurance full time? ☐ Yes ☐ No

11 Does the worker sell other types of insurance for the firm? ☐ Yes ☐ No
If "Yes," enter the percentage of the worker's total working time spent in selling other types of insurance %

12 If the worker solicits orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments, enter the percentage of the worker's time spent in the solicitation %

13 Is the merchandise purchased by the customers for resale or use in their business operations? ☐ Yes ☐ No
Describe the merchandise and state whether it is equipment installed on the customers' premises.

Part V Signature (see page 4)

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete.

Signature ▶ Title ▶ Date ▶
(Type or print name below)

Form SS-8 (Rev. 6-2003)

Summary

- Why is the definition of "employee" important? The distinction between employees and independent contractors is crucial from a financial perspective. Because many regulations require different responsibilities from employers of employees and independent contractors, it is imperative that an employer be confident of the classification of its employees.
- How does an employer make the distinction between employees and independent contractors? The classification of employees may vary depending on the statute that is to be applied or on the court in which a given case is scheduled to be heard. However, the common thread is generally the right of the employer to control the actions of the worker. Where this is present, the worker is likely to be considered an employee. Other factors to be considered include those that are part of the economic realities test, which evaluates the economics of the employment situation. Finally, some workers may be classified statutorily as employees, making the distinction all the easier.
- Who is an "employer"? The definition of employer is generally agreed on. An employer is usually thought to be one who employs or uses others (either employees or independent contractors, or both) to do its work, or to work on its behalf.
- When an employer decides to terminate an employee, there is always a reason for the termination. That reason need not be fair, or even justified; the only restriction is that it should not be made on *improper* bases.
- To ensure that the discharge decision is not wrongful and to protect against a claim of wrongful discharge, employers should establish a discharge procedure to be followed in the course of every termination.
    1. The supervisor with the authority to make the termination decision should draft written responses to the following questions:
       —What is the nature of the action to be taken?
       —What is the factual basis for this action?
       —Is there any evidence of this factual basis, oral or written?
       —If this action is based on the employee's behavior, did the employee obtain permission or give notice of her or his intent to engage in this behavior prior to doing so? (For instance, if the employee needed to take time off for a stated purpose, did she or he first receive permission to do so? [If permission has been granted, termination based on this behavior may constitute outrageous conduct.])
       —If this action is based on the employee's behavior, is this behavior of the type in which she or he has a right or obligation to engage by law (such as jury duty, testifying pursuant to a subpoena, etc.)?
       —If this action is based on the employee's behavior, is this a type of behavior that an employer ought to encourage (such as assisting in the investigation of a crime)?
       —If this action is based on the employee's behavior, did this behavior harm us, as an organization? [Termination would be subject to greater scrutiny.]
       —Is this action based on an omission or refusal to act on the part of the employee? If so, did the employee refuse to act in such a manner that could be construed as unethical, immoral, illegal, or humiliating?
    2. Once the supervisor has responded to the above questions, the supervisor and an individual specifically chosen to review discharge decisions should review the responses to address whether they may give rise to liability. Where the potential exists, the employer is now better equipped to determine the costs and benefits of the anticipated action.
    3. After a review of the facts and the supervisor's responses, it is in the employer's best interests to investigate the events leading to the discharge and to solicit a response from the employee relating to the possibility of termination. It allows the employee to feel as if she or he has had the opportunity to be heard. It also ensures that all of the relevant facts have been brought to the surface.

4. After the hearing, the supervisor and the termination "specialist" should review the information in light of earlier decisions and appropriate business judgment; consistency is crucial and the best defense.

Chapter-End Questions

1. Holtzman began working for World Book as a part-time sales representative in 1983. Her position required selling World Book's educational products. Until 1995, she worked as a part-time sales representative and then a district manager for World Book. In 1995, World Book decided to separate the parent division from the school and library division and reorganize its sales force by outsourcing: contracting with individual "regional directors" who would in turn contract with individual sales representatives. The same people who had worked for World Book under the previous arrangement filled many of the positions under the new structure, in which branch managers became separately incorporated regional directors and district managers while sales representatives took positions with the newly formed companies.

   Holtzman signed a contract with Lee, a former World Book branch manager who had formed her own corporation and gathered a sales force consisting largely of former World Book sales representatives. Holtzman eventually became a territory coordinator, a position slightly above sales representative but still reporting to Lee. In 1998, Holtzman was told that she was losing her territory and would no longer be selling World Book products. Holtzman sued World Book, claiming that the loss of her territory was effectively a termination. What is the result of her lawsuit? [*Holtzman* v. *The World Book Company, Inc.,* 2001 U.S. Dist. LEXIS 18531 (E.D. Pa. Nov. 13, 2001).]
2. Think about the following questions from the point of view of violation of public policy or breach of a covenant of good faith and fair dealing, and see what the outcome would be.
   a. An employee was suspended pending discharge for sleeping and "loafing" on the job. The employer offered to change the penalty to suspension without pay if the plaintiff would sign a "last-chance agreement" under which he waived and released "any claims, suits, or causes of action" against the defendant. The employee refused to sign because he was unwilling to waive his rights to state unemployment benefits or workers' compensation. Under state statute, agreements to waive such rights are invalid. The employee is discharged. [*Edelberg* v. *Leco Corp.,* 236 Mich. App. 177 (1999).]
   b. A nurse is asked by her employer to sign a backdated Medicare form. She refuses, and is terminated that day. As a health care provider, she is required to complete that particular form. [*Callantine* v. *Staff Builders, Inc.,* 271 F.3d 1124 (8th Cir. 2001).]
   c. A legal secretary to a county commissioner is terminated because of her political beliefs. [*Armour* v. *County of Beaver,* 271 F.3d 417 (3d Cir. 2001).]
   d. A company's lawyer is terminated when he refuses to remove, from the company's files, documents that would be harmful to the company if they were given to opposing counsel under a discovery order in litigation the company is involved in. [*Herbster* v. *Northern American Co. for Life and Health Ins.,* 501 N.E.2d 343 (Ill. App. Ct. 1986), cert. denied, 484 U.S. 850 (1987).]
   e. Employee is terminated because she married a co-worker. [*McCluskey* v. *Clark Oil & Refining Corp.,* 498 N.E.2d 559 (Ill. App. Ct. 1986).]
   f. Employee discovers that his supervisor is involved in a wrongdoing. The supervisor terminates the employee to prevent the employee from disclosing her wrongdoing to higher-level management. [*Adler* v. *American Standard Corp.,* 830 F.2d 1303 (4th Cir. 1987).]

g. A legal secretary is hired by a law firm. The Letter of Employment stated, "In the event of any dispute or claim between you and the firm . . . including, but not limited to claims arising from or related to your employment or the termination of your employment, we jointly agree to submit all such disputes or claims to confidential binding arbitration, under the Federal Arbitration Act." On his third day of work, the employee informs his superiors that he would not agree to arbitrate disputes. He was told that the arbitration provision was "not negotiable" and that his continued employment was contingent upon signing the agreement. The employee declined to sign the agreement and was discharged [*Lagatree* v. *Luce, Forward, Hamilton & Scripps,* 74 Cal. App. 4th 1005 (Cal. App. 2d Div. 1 1999).]

h. Employee is licensed to perform certain medical procedures, but he is terminated for refusing to perform a procedure he is not licensed to perform. [*O'Sullivan* v. *Mallon,* 390 A.2d 149 (N.J. Super. Ct. Law Div. 1978).]

i. An employee was fired from his job as security manager for a medical center because he was suspected of making an obscene phone call to another employee and refused to submit to voice print analysis to confirm or refute the accusation. He sued the employer for wrongful discharge, claiming that the employer's request violated public policy. A state statute prohibits an employer from requiring an employee to submit to a polygraph examination as a condition or precondition of employment. [*Theisen* v. *Covenant Medical Center,* 636 N.W.2d 74 (Iowa 2001).]

3. Is a covenant not to compete enforceable when it prohibits a doctor from practicing medicine for two years from the date of his employment termination within a 10-mile radius of hospitals to which his former practice provides services? [*Medical Specialists* v. *Sleweon,* 652 N.W.2d 517 (Ind. 1995).]
4. Mariani was a licensed CPA who worked for Colorado Blue Cross and Blue Shield as manager of general accounting for human resources. She complained to her supervisors about questionable accounting practices on a number of occasions and was fired. She claims that her termination was in violation of public policy in favor of accurate reporting, as found in the Board of Accountancy Rules of Professional Conduct. BCBS claims that the rules are not an arbiter of public policy as ethics codes are too variable. Who is correct? [*Rocky Mountain Hospital* v. *Mariani,* 916 P.2d 519 (Colo. 1996).]
5. An employee receives a letter of reprimand that goes in his personnel file but is not demoted and does not suffer any other action. Does the letter constitute an adverse employment action? [*Krause* v. *LaCross,* 87 FEP Cases 1475 (7th Cir. 2001).]
6. A staffing firm provides landscaping services for clients on an ongoing basis. The staffing firm selects and pays the workers, provides health insurance, and withholds taxes. The firm provides the equipment and supplies necessary to do the work. It also supervises the workers on the clients' premises. Client A reserves the right to direct the staffing-firm workers to perform particular tasks at particular times or in a specified manner, although it does not generally exercise that authority. Client A evaluates the quality of the workers' performance and regularly reports its findings to the firm. It can require the firm to remove a worker from the job assignment if it is dissatisfied. Who is the employer of the workers?
7. The Duprees, Terry and Jerry, are former employees of UPS. They both started working for UPS as hourly union employees and were protected by union laws against being fired except "for cause." They were both promoted to managerial positions, which they accepted on the representation that they would retain job security since managerial positions were not provided with union protection. Soon after her promotion, Terry Dupree alleged that a senior manager, Pepper Simmons, was sexually harassing her. A few months after Terry Dupree's allegation, Simmons allegedly discovered that Terry was dating Jerry, who was in

the same managerial level as Terry. Simmons, according to the Duprees, vowed to "get his job," and Jerry Dupree was soon fired for violating the UPS fraternization policy. The Duprees say that it was their understanding that this policy only governed relations between supervisors and hourly employees, not relations between two supervisors. Terry Dupree filed a sexual harassment complaint against Simmons, on which UPS took no disciplinary action. After Terry filed this complaint, her supervisors began "writing her up" for infractions of company policy. After several infractions, the UPS management offered her $12,000 to resign. She refused and was fired. Oklahoma recognizes a cause of action arising from the termination of an at-will employee against an employer in "cases in which the discharge is contrary to a clear mandate of public policy as articulated by constitutional, statutory or decisional law." What result? [*Dupree* v. *United Parcel Service, Inc.,* 956 F.2d 219 (10th Cir. 1992).]

8. Alberto Camargo was killed when his tractor rolled over as he was driving over a large mound of manure in a corral belonging to Tjaarda Dairy. Camargo was an employee of Golden Cal Trucking, and Golden Cal Trucking was an independent contractor that Tjaarda Dairy had hired to scrape the manure out of its corrals and to haul it away in exchange for the right to purchase the manure at a discount. Plaintiffs, Camargo's wife and five children, sued defendants Tjaarda Dairy and Perry Tjaarda on the theory, among others, that they were *negligent in hiring* Golden Cal Trucking because they failed to determine whether Camargo was qualified to operate the tractor safely. Is Tjaarda Dairy liable for Camargo's death? [*Camargo* v. *Tjaarda Dairy,* 25 Cal. 4th 1235 (2001).]

9. Patricia Meleen, a chemical dependency counselor, brought charges alleging wrongful discharge, defamation, and emotional distress against the Hazelden Foundation, a chemical dependency clinic, in regard to her discharge due to her alleged sexual relations with a former patient. Hazelden's written employment policies prohibited unprofessional and unethical conduct, including sexual contact between patients and counselors. A former patient alleged that Meleen had initiated a social and sexual relationship with him within one year of his discharge. A committee appointed by Hazelden told Meleen of the allegation against her and suspended her with pay in spite of Meleen's denial that she was involved in any improper relations or sexual contact with the former patient. Hazelden offered Meleen a nonclinical position, and, when she refused, she was dismissed. Is the dismissal wrongful? [*Meleen* v. *Hazelden Foundation,* 928 F.2d 795 (8th Cir. 1991).]

10. Farlow graduated from law school in 1988 and was employed by Wachovia Bank of North Carolina to represent it. In 1993, Wachovia discussed the possibility of Farlow's working as in-house counsel for Wachovia to handle recovery and bankruptcy cases. On her employment application, Farlow disclosed that she had been convicted of two counts of misdemeanor larceny in 1982. Those convictions made it unlawful for her to become an employee of Wachovia without FDIC approval. Wachovia proceeded with its working relationship with Farlow, who closed her private practice and moved on site with Wachovia. The parties executed a written contract under which Farlow would provide legal services as an independent contractor. Both parties intended that Farlow would not be considered an employee unless the FDIC waiver was obtained. Such a waiver was never sought for Farlow.

    Farlow was considered an independent contractor for tax purposes and was never paid a salary by Wachovia but, instead, was paid for the bills she submitted. She received no benefits or compensation for business travel. She used letterhead that designated her simply as an attorney-at-law and did not receive business cards. However, she was provided with on-site office space, support, staff, equipment, and the use of company vehicles. She was paid for continuing education. Wachovia exercised control over the hours in which she had access to her office.

After complaining about a sexually and racially hostile work environment. Farlow was terminated. She filed several claims under Title VII. Was Wachovia Farlow's employer? [*Farlow* v. *Wachovia Bank of North Carolina,* 259 F.R.D. 309 (4th Cir. 2001).]

11. Max Huber was the agency manager at Standard Insurance's Los Angeles office. He was employed as an at-will employee, and his contract did not specify any fixed duration of guaranteed employment. Huber was discharged by the company after eight years because of his alleged negative attitude, the company's increasing expense ratio, and the agency's decreasing recruiting. Huber provided evidence that he had never received negative criticism in any of his evaluations, and that his recruiting had been successful. Huber demonstrated that, even though the company had a decrease in recruitment during his employment, he himself had a net increase of contracted agents of 1,100 percent. Huber claims that he was discharged because he was asked to write a letter of recommendation about his supervisor, Canfield, whose termination was being considered. Johnson, Canfield's supervisor, was disappointed with the positive recommendation that Huber wrote because it made Canfield's termination difficult to execute. Johnson is alleged to have transferred Huber to expedite Canfield's termination, and he eventually discharged Huber in retaliation for the positive letter of recommendation. If Huber files suit, what result? [*Huber* v. *Standard Insurance Co.,* 841 F.2d 980 (9th Cir. 1988).]