Anderson Kill & Olick, P.C.
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# What's New: Outsourcing: Legal Pitfalls

By Jerry Hartman

*This edition of the Employment Law Insider discusses the new trend toward "outsourcing," or using contract workers, and its attendant legal problems. As discussed below, an employer who uses such workers could be held liable under various antidiscrimination laws, even though that employer does not pay the employee or have absolute control over the employee's work.*

*In "Briefly Noted," we discuss, among other things, one of the first appellate court cases to discuss an employer's obligations under the Family and Medical Leave Act. Our "Case Study" applies the principles set out in our lead article in outsourcing and analyzes the issue of whether a company should be considered an "employer" under the antidiscrimination laws. Finally, in "Labor Law Developments," we update you on the new Supreme Court decision which held that paid union organizers are "employees" subject to the protections of the National Labor Relations Act.*

An employer "outsources" when it contracts with a company (typically, an employee leasing company) to provide certain services. The leasing company hires employees to perform these services, and these workers are sometimes referred to as "leased employees" or "contract workers." For example, an employer (or "client company") might contract with a leasing company to provide on-site copying services or secretarial services.

In the typical outsourcing arrangement, the leasing company actually manages and supervises the employees, although the employees may work on the premises of the client company. The leasing company pays the employees, and handles tax withholding and overtime compliance. Obviously, this arrangement relieves the client company from the headaches and cost of administering payroll, benefits coordination, and supervision of employees. Yet, with these benefits come exposure to a host of unexpected legal problems.

### *An Employer Can Be Held Liable for Unlawful Discrimination Against a Leased Employee*

If a leased employee complains of unlawful discrimination in the workplace, the following question arises: who is the leased employee's "employer" under the various antidiscrimination laws -- e.g., Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, and the Age Discrimination in Employment Act? In other words, who can the employee sue? Some federal courts have held that, if the client company has sufficient control over the leased employee's performance, the leasing service and the client employer may be "joint employers" who can both be legally liable for discrimination. *Amarnare v. Merrill, Lynch, Pierce,*

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Labor Law Developments:

## Supreme Court Approves Union Organizing Technique of "Salting"

By Bennett Pine

In the Fall 1994 and the Winter 1994/1995 Editions of the Employment Law Insider, we reported on important decisions by the National Labor Relations Board and the United States Court of Appeals for the Eighth Circuit on the issue of whether paid union organizers who apply for jobs with a non-union employer, with organizational activities in mind, are "employees" entitled to the protections of the National Labor Relations Act.

In a decision being hailed as a victory for organized labor, the United States Supreme Court in *NLRB v. Town & Country Electric*, Inc. (November 28, 1995) found that the National Labor Relations Board properly determined that the definition of the word "employee" must include paid union organizers known as "salts." "Salting" is commonly used by unions as an organizing technique in construction and in other industries.

"Can a worker be a company's `employee'...if, at the same time, a union pays that worker to help the union organize the company?" asked Justice Stephen Breyer, writing for a unanimous Court. "We agree with the National Labor Relations Board that the answer is `yes.'"

Town & Country, a large non-union electrical contractor from Wisconsin, had obtained a contract to do electrical work in Minnesota. Upon learning that Minnesota required electrical contractors to employ one state-licensed electrician for every two non-state-licensed electricians working at a job site, Town & Country retained Ameristaff, a temporary employment agency, to help recruit Minnesota-licensed electricians. After conducting three interviews, Town & Country hired a union member, Malcom Hansen,

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*Fenner & Smith, Inc.*, 611 F. Supp. 344 (S.D.N.Y. 1984), affirmed, 770 F.2d 157 (2d Cir. 1985) (temporary administrative assistant who was discharged after two weeks could sue client company for discrimination because company had right to control the means and manner of her performance); *Magnuson v. Peak Technical Services, Inc.*, 808 F. Supp. 500 (E.D. Va. 1992) (leased employee could sue automobile company and dealership for sexual harassment and discrimination because the company and the dealership made personnel decisions relating to her employment, provided ongoing training, and received reports on her work performance). But see *Lattanzio v. Security National Bank*, 825 F. Supp. 86 (E.D. Pa. 1993) (cleaning person who set her own hours could not sue company for discrimination).

### *Leased Employees Can De-Rail an Employer's Efforts To Maintain a Union-Free Environment*

An employer may have to include leased employees in a potential bargaining unit for purposes of voting in a National Labor Relations Board election. *NLRB v. Western Temporary Services*, 821 F.2d 1258 (7th Cir. 1987) (contract workers could vote along with the company's regular employees in a National Labor Relations Board election because they all shared a sufficient "community of interest"). See also, *Carrier Corp. v. NLRB*, 768 F.2d 788 (6th Cir. 1985) (client company who had substantial day-to-day control over leased truck drivers violated the National Labor Relations Act by threatening drivers with adverse action if they unionized).

### *A Company May Have to Pay Unemployment Taxes and Workers' Compensation Contributions for Leased Employees*

If a client company exercises sufficient control or direction over leased employees, it may be responsible for paying workers' compensation contributions and unemployment taxes for a leased employee. See *Maynard v. Kenova Chemical Co.*, 626 F.2d 359 (4th Cir. 1980); *St. Clair v. Minnesota Harbor Service, Inc.*, 211 F. Supp. 521 (D. Minn. 1982); *State of North Carolina v. L. Harvey & Son Company*, 42 S.E.2d 86 (N.C. 1947).

### *Employers May Have to Count Leased Employees in Determining Whether Benefit Plans Meet Legal Requirements*

Client companies may need to consider leased employees in determining whether their benefit plans meet discrimination and other requirements. The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") provides that, while the leasing company must comply with all applicable employee benefit laws with respect to the leased employee, the client company must "count" the leased employee as an employee when determining whether its plan meets certain qualification requirements. One of these requirements is that pension plans cannot disproportionately benefit certain employees. TEFRA thus prevents employers from providing benefits solely for their highly compensated employees by leasing all of their lower paid employees. Keep in mind, however, that a client company does not have to allow the leased employee to receive benefits from its plans.

### *The Family and Medical Leave Act Requires that Client Companies Count Leased Employees as Regular Employees*

Under the FMLA, the client company, as well as the leasing company, must count leased employees when determining whether each company is covered by the FMLA (the FMLA generally covers companies that employ 50 or more employees). For example, an employer who jointly employs 15 workers from a leasing agency and 40 permanent workers at a single site is covered by FMLA. While only the leasing company would be responsible for providing FMLA leave, the client company must accept the employee returning from FMLA leave in place of an employee who has taken the returning employee's position, if the replacement employee is from the leasing agency.

### *How to Avoid the Risk of Joint Employer Status*

- Have the leasing service provide its own supervisor for the workers and allow the leasing company to discipline and discharge employees.
- Try to avoid having leased employees in the workforce for excessive periods of time. The longer the relationship lasts, the greater likelihood that joint employment will be found.
- If concerned about unions, try to limit the interaction between regular employees and leased workers so as to reduce the likelihood they will be found to share a "community of interest."
- Include an indemnification provision in the leasing agreement for violations of federal and state law, including the costs of defending against charges of alleged violations. Also include provisions in the leasing agreement that only the

leasing company will be responsible for making unemployment, disability, workers' compensation, and social security contributions. ■

## Briefly Noted: Congress Considers Bill That Would Make Damages Received for Employment Discrimination Taxable

By Diane M. Horan

Section 104(a)(2) of the Internal Revenue Code currently excludes from income all damages received, either from suit or settlement, "on account of personal injuries or sickness." The question arises as to how this rule applies to settlements and awards received by plaintiffs in discrimination suits — are those monies received "on account of personal injuries or sickness" and thus tax-free?

In June of 1995, the Supreme Court ruled in *Commissioner v. Schleier* that back pay and liquidated damages recovered under the Age Discrimination in Employment Act are not excludable from gross income under Section 104(a)(2), and thus, are taxable. In light of the Supreme Court's decision, the IRS suspended Revenue Ruling 93-88, issued in 1993, which had held that any money that plaintiffs received in satisfaction of claims of disparate treatment under the Civil Rights Act of 1991 or the Americans With Disabilities Act were excludable from income under Section 104(a)(2), and called for public comment on the issue of taxability of monies received in accord of employment discrimination claims.

To add to the confusion, prior to Schleier, some courts had ruled that "personal injuries" encompass nonphysical injuries such as employment discrimination. Some courts even had permitted plaintiffs to exclude from income punitive damages, reasoning that they, too, are received "on account of" personal injury. Because of this broad judicial interpretation of Section 104(a)(2), plaintiffs in some cases had agreed to smaller settlements, an obvious benefit to defendants, in the expectation that the money will be received tax-free.

Now, Congress is considering a bill which would make damages received for employment discrimination under the various antidiscrimination laws fully taxable. If Section 11311 of the Revenue Reconciliation Bill of 1995 becomes law, defendants may need to dish out more money on settlements. That bill provides that (1) amounts received as damages for nonphysical personal injuries (including employment discrimination) are fully taxable, and (2) almost all punitive damages —even punitive damages paid in connection with physical injury — must be included in income as well.

Section 11311 also provides that damages for emotional distress are fully taxable unless they relate to a physical injury. An exception is made for emotional distress damages to the extent that the plaintiff has incurred medical expenses for the treatment of emotional distress. If Section 11311 is enacted, it will apply to all damage payments made after December 31, 1995, except for payments made after that date pursuant to an order or binding written agreement in effect on or

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with knowledge of his union membership. Hansen was technically employed by Ameristaff and leased out to Town & Country. Town & Country refused to interview two paid union organizers.

Hansen began organizational activities as soon as he started work at the job site. After work had begun at the site, Town & Country learned that Minnesota did not allow contractors to employ temporary workers to fulfill the licensed-electrician requirement. Town & Country informed Ameristaff that they no longer needed Hansen, and did not want to hire him directly.

The National Labor Relations Board found that Hansen and the two paid union organizers who applied for jobs with Town & Country were "employees" under the Act. Thus, said the Board, Town & Country violated the Act by refusing to interview the two paid union organizers because of their union affiliation and by refusing to retain Hansen because of his union activity at the job site. On appeal, the Eighth Circuit reversed, on the basis that the paid union organizers could not be "employees" protected by the Act.

Justice Breyer of the United States Supreme Court stated that under the National Labor Relations Act, the phrase "any employee" is to be broadly interpreted. He also explained that a person may be the servant of two different masters and likened the situation to "moonlighting," a widely accepted practice whereby an employer's control over its workforce is limited to their assigned duties during working hours. Breyer added that a company has adequate means to discipline or terminate "salted" or other employees who are poor workers, or who engage in sabotage or other disloyal activities -- but stated that such individuals are nevertheless "employees" within the meaning of the Act and entitled to its protections.

The Supreme Court's decision in Town & Country is a significant one, as the issue of NLRA coverage for paid union organizers was presented in approximately 70 cases pending before the Board as the time of the Court's decision. Union leaders embraced the Supreme Court's ruling as vindicating "salting" as a viable organizing tactic. Management supporters denounced "salting" as a government endorsed disruption of the workplace requiring companies to "have employees whose sole purpose is to put them out of business." The introduction of legislation to reverse the effect of the Supreme Court's decision is a possibility. ■

before September 13, 1995. Because some or all taxable payments to employees or former employees may be deemed "wages" subject to withholding tax, if this bill becomes law, corporate defendants must ensure that they withhold the appropriate tax to avoid penalties.

As a result of Schleier, the IRS's suspension and possible modification of Revenue Ruling 93-88, and the tax bill pending in Congress, no clear guidance currently exists on the taxation of recoveries in the different types employment discrimination cases. Keep an eye out for further updates in the Employment Law Insider.

### *Employee Not Required to Designate Leave as FMLA Leave*

In one of the first appellate cases decided under the Family and Medical Leave Act, the United States Court of Appeals for the Fifth Circuit has held that an employee who is terminated pursuant to a "no-fault" absenteeism policy need not expressly invoke the FMLA or its protection when taking leave for his or her own serious health condition. In reversing the decision of the court below, the Fifth Circuit in *Manuel v. Westlake Polymers Corporation* found that the Department of Labor's final regulations resolve the issue by providing that "[t]he employee need not expressly assert rights under the FMLA or even mention the FMLA, but may only state that leave is needed." The facts presented in Manuel demonstrate the hardship employers often encounter in administering a "no-fault" absenteeism policy, in light of the requirements of the FMLA.

In Manuel, the plaintiff began working for Westlake Polymers Corporation in July of 1986. Throughout her employment with Westlake, the plaintiff missed numerous days of work. In 1987, for example, the plaintiff missed 17 days, in 1988 she missed 49 days and in 1990 she missed 30 days. In 1992, Westlake established a "no-fault" absenteeism policy, and the plaintiff was warned of her excessive absences under that policy in February, July and September of 1992.

On December 30, 1992, Westlake sent the plaintiff a formal warning letter notifying her that, since the last warning three months earlier, she had missed approximately 14 days of work.

On October 6, 1993, Manuel had surgery to remove an ingrown toenail and, as a result of complications, did not return to work for over one month. At no time did the plaintiff request that these days off from work be counted as FMLA leave. When the plaintiff did return to work, she was suspended by Westlake and given written notice that her employment would be terminated if her excessive absences continued. Less than two months later, the plaintiff became ill while at work and went home. She returned to work after three days but, upon her return to work, was terminated by Westlake pursuant to its "no-fault" absenteeism policy. Shortly thereafter, the plaintiff sued Westlake for violating the FMLA because it counted the October-November, 1993 absences under its no-fault policy.

In reversing the lower court's decision in favor of Westlake, the Fifth Circuit reasoned that "requiring employees unable to foresee their need for leave to expressly invoke the FMLA's protection would significantly burden the employees." The court concluded that Congress did not intend "to impose such an onerous requirement on employees," noting that employees such as the plaintiff "are workers, not lawyers." Accordingly, the court ruled that the FMLA prevented Westlake from counting the absences occasioned by the surgery to remove the plaintiff's ingrown toenail as absences under the "no-fault" policy. The court, however, expressed no opinion as to whether the plaintiff's surgery for an ingrown toenail and the resulting treatment due to complications constituted a "serious health condition." ■

## Case Study

By Greg Homer

Winifred Miller works for Executive Caterers, a company which provides personnel to large corporations to handle their day-to-day catering and food needs, such as setting up client luncheons and dinners, keeping the kitchens stocked with sodas, coffee, and other food items, and planning various special events for the corporation. Winnie has been assigned to work at Globalnet, a large internet services provider which has huge corporate clients all over the United States and Europe. Due to the recent expansion of Globalnet, including its discussions with other internet services providers concerning possible mergers, several corporate luncheons or dinners a week take place. Winnie works with two assistants, also from Executive Caterers, to help her handle the high volume of work. Catering is Winnie's second career; she was a teacher for 25 years. Winnie is 55 years old.

Executive Caterers pays Winnie's salary and benefits. Winnie also has a supervisor at Executive Caterers, Todd Papageorge, who sporadically visits Globalnet to observe Winnie's performance, keeps track of Winnie's workload through weekly discussions with Winnie, and solicits evaluations of Winnie's performance from Globalnet employees in the form of written performance reviews. At the end of the year, Mr. Papageorge gives Winnie a performance review and recommends to the president of Executive Caterers the amount of a salary increase Winnie should receive.

Winnie works at Globalnet from Monday through Friday, 9:00 a.m. to 6:00 p.m. Sometimes, Globalnet will schedule client dinner meetings at the company, and will ask Winnie to work overtime. While at Globalnet, Winnie has little interaction with Executive Caterers. She takes daily direction from the personnel at Globalnet, and orders any food or other items on her own and independent of Executive Caterer's input. Many times, individuals at Globalnet have asked her to make special arrangements for lunch or dinner client meetings.

Winnie's performance at Globalnet has been mixed. Although she deals with clients well and has good organizational skills, she often reports to work late. The Office Manager at Globalnet has reprimanded her on a few occasions regarding her lateness. Winnie also does not get along well with certain high level company officials. She is very outspoken, and that has rubbed certain people the wrong way. For example, a department head had complained about the fact that Winnie was late in setting up a dinner meeting, and she responded, "Well, that's not my problem, you people are working me to death!"Recently, Winnie has been very busy setting up luncheons and dinners for client meetings, and has felt overwhelmed with the amount of work involved. She has been feeling very tired, and has not been able to get to work on time. Her stress level and fatigue have been mounting. One day, she set up a luncheon between the supervisors in the customer service department and a prospective new corporate client. During the luncheon, one of the supervisors chided her because the food was cold and also said to her, "Grandma, get us some salt." Winnie, exasperated, said in reply, "Get it yourself, I'm too tired," and walked out of the room.

The supervisor, enraged by this insubordination, talked to the Executive Committee of Globalnet and recommended that Winnie be fired. The Executive Committee agreed. The supervisor then called Mr. Papageorge at Executive Caterers to get his approval, and explained to Mr. Papageorge that he needed someone with more stamina and who was not "crotchety and set in her ways." Mr. Papageorge agreed that Winnie should be discharged from her position with Globalnet and also decided to fire her from Executive Caterers.

Winnie, believing that she was fired unlawfully because of her age, brought suit against Globalnet and Executive Caterers under the ADEA. Globalnet moved for summary judgment on the basis that it was not Winnie's employer and thus it could not be liable for age discrimination.

### *Analysis*

Globalnet may have a tough time convincing a judge that it was not Winnie's employer. See "What's New — Outsourcing: Legal Pitfalls". Although Executive Caterers paid Winnie's salary and benefits, and placed Winnie in her position at Globalnet, Globalnet exercised control over Winnie's day-to-day activities, including directing her work and requesting that she work overtime on several occasions.

Globalnet submitted performance reviews to Globalnet, and thus had a hand in Winnie's year-end performance review and compensation. Globalnet also controlled Winnie's performance by disciplining her for being late, and made the initial decision to discharge Winnie.

However, other factors point to Executive Caterers as the employer. Winnie talked to Mr. Papageorge every week concerning her assignments, and Mr.Papageorge observed her performance in person. Mr. Papageorge conducted her year-end performance review and made salary recommendations to the president of Executive Caterers. Also, it appears that the final decision to discharge Winnie was made and approved by Mr. Papageorge.

Given the fact situation set out above, although Executive Caterers had some control over Winnie, Globalnet also exercised a large amount of control over her performance, and a federal court could find that Globalnet and Executive Caterers were joint employers for purposes of the ADEA and thus both subject to liability for age discrimination.

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