Winter 2002

Rethinking the Legal Oversight of Benefit Program Exclusions

Mark Berger
University of Missouri School of Law

RETHINKING THE LEGAL OVERSIGHT OF BENEFIT PROGRAM EXCLUSIONS

*Mark Berger**

I. INTRODUCTION

The American workforce is comprised of over 125 million individuals.[1] Most depend upon earnings from their employment to cover the basic necessities of life, such as food and shelter. Increasingly, American workers have also come to rely upon employers to provide employee benefit programs that include such critical items as health insurance and retirement savings plans.[2] However, employers are finding that providing benefits to employees is a costly undertaking.[3] As a result, firms have been under

---

* Oliver H. Dean Distinguished Scholar and Professor of Law, University of Missouri—Kansas City School of Law. B.A. 1966, Columbia; J.D. 1969, Yale Law School. Preparation of this article was supported by a grant from the UMKC Law School Research Fund.

1. The Bureau of Labor Statistics reported that the working population of the United States in January, 2001, was 136 million. At the same time the unemployment level was close to six million. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, EMPLOYMENT SITUATION SUMMARY, Table A-1, *available at* http://stats.bls.gov/news.release/empsit.nr0.htm (last visited March 19, 2002).

2. This has been particularly true with respect to health insurance since the 1940s. World War II wage controls did not apply to insurance plans paid for by the employer and, therefore, health insurance came to be substituted for wage increases. Craig J. Catoni, *The Case Against Employee Benefits,* WALL ST. J., Aug. 18, 1997, at A14. Employer pension plans have become increasingly important with the aging of the American population which has led to larger numbers of retired individuals who are likely to need retirement income for a longer period of time. The U.S. Bureau of the Census estimated that out of an American population of 248 million in 1990, 31 million were over 65 years of age. For the year 2000, the Bureau of the Census estimate was of a population of 276 million, 35 million of whom were over 65. This represents an increase of four million individuals in the over 65 category, along with an increase in this age group's percentage of the total population from 12.5% to 12.7%. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, RESIDENT POPULATION ESTIMATES OF THE UNITED STATES BY AGE AND SEX: APRIL 1, 1990 TO JULY 1, 1999, WITH SHORT-TERM PROJECTION TO NOVEMBER 1, 2000 (Jan. 2, 2001), *available at* http://www.census.gov/population/estimates/nation/intfile2-1.txt (last visited March 19, 2002). As of the year 2000, a male aged 65 was estimated to have a life expectancy of 20.5 years, compared to 17.8 years in 1983. John M. Bragg, *New Mortality Table Shows Up on Annuity Block,* NAT'L UNDERWRITER LIFE & HEALTH-FIN. SERVS. ED., Jan 20, 1997, at 8.

3. The Bureau of Labor Statistics estimated that average benefit costs for American civilian workers amounted to 27% of total employee compensation. BUREAU OF LABOR

intense pressure to control benefit costs and restrict coverage wherever possible.[4]

One illustration of the effort to limit the cost of benefit programs by restricting coverage is provided by the litigation arising from the Microsoft Corporation's exclusion of its non-regular "freelance" workforce from company-sponsored employee benefit plans. The affected employees filed a class action lawsuit challenging the decision to deny them the right to participate in the company's retirement and stock purchase programs. The resulting litigation produced multiple rulings from the Ninth Circuit Court of Appeals[5] and has stimulated the filing of lawsuits against other employers

---

STATISTICS, U.S. DEP'T OF LABOR, EMPLOYER COSTS FOR EMPLOYEE COMPENSATION - MARCH 2000, Table 1 (June 29, 2000), *available at* http://www.bls.gov/news.release/ecec.t01.htm (last visited March 19, 2002). A U.S. Chamber of Commerce survey reported that benefits amounted to one-third of payroll costs, with health insurance constituting the most expensive item. *See Benefits Were One-Third of Payrolls in 1999*, 167 LAB. REL. REP. (BNA) 17 (May 7, 2001).

4. Rising health insurance and pension costs have led many companies to cease offering health insurance and pension benefits to their employees. One survey reported that the percentage of small businesses offering such benefits declined from 46% in 1996 to 39% in 1998. Rodney Ho, *Fewer Small Businesses Are Offering Health Care and Retirement Benefits*, WALL ST. J., June 24, 1998, at B2. Other companies have responded to the problem by increasing their utilization of leased, part time, or temporary staff who do not receive benefits. It has been observed that the "cost of benefits for contingent workers is almost always less than for regular employees because few contingent workers get any benefits. This is one of the reasons why companies use contingent workers." Stanley D. Nollen & Helen Axel, *Benefits and Costs to Employers, in* CONTINGENT WORK: AMERICAN EMPLOYMENT RELATIONS IN TRANSITION 126, 134 (Kathleen Barker & Kathleen Christensen eds., 1998). Observers are consistent in their conclusions that the use of contingent workers is on the rise. *See* ECONOMIC POLICY INST., NONSTANDARD WORK, SUBSTANDARD JOBS: FLEXIBLE WORK ARRANGEMENTS IN THE U.S. (1997); Richard Belous, *The Rise of the Contingent Workforce: The Key Challenges and Opportunities*, 52 WASH. & LEE L. REV. 863 (1995). Congressional concern has been reflected in hearings held on contingent workforce issues. *See Conference on the Growing Contingent Workforce: Flexibility at the Price of Fairness?: Hearings on S. 472 Before the Subcomm. On Labor of the Senate Comm. On Labor and Human Resources*, 103d Cong. (1994); *The Rising Use of Part-Time and Temporary Workers: Who Benefits and Who Loses?: Hearing Before a Subcomm. Of the House Comm. On Gov't Operations*, 100th Cong. (1988).

5. Vizcaino v. Microsoft Corp., 97 F.3d 1187 (9th Cir. 1996) [hereinafter Vizcaino I]; 120 F.3d 1006 (9th Cir. 1997) (en banc) [hereinafter Vizcaino II], *cert. denied*, 522 U.S. 1098 (1998). Additional litigation addressed issues relating to the scope of the class remaining in the suit following the earlier litigation. Vizcaino v. Microsoft Corp., 1998 WL 122084 (W.D. Wash. 1998); Vizcaino v. United States Dist. Court for W. Dist. of Wash., 173 F.3d 713 (9th Cir.), *en banc hearing denied*, 184 F.3d 1070 (9th Cir. 1999), *cert. denied*, 528 U.S. 1105 (2000).

who have used similar tactics.[6] In the end, the plaintiffs prevailed and Microsoft settled the case for $97 million.[7] The importance of the litigation, however, goes well beyond its impact on Microsoft. The events surrounding the lawsuit as well as the legal analysis used by the courts in reviewing Microsoft's personnel and benefit systems have raised important questions about the extent to which employers are free to restrict benefit program eligibility.[8]

What Microsoft in fact did was to create a two-tier employment system for its workforce. One group was composed of those in traditional full-time positions without any defined durational limits. The Ninth Circuit Court of Appeals panel called them "permanent employees,"[9] but there was nothing to indicate that they were given tenure or guaranteed lifetime employment. Instead, the Microsoft "permanent" workers were typical at-will employees[10] subject to discharge at the company's discretion, but without

6. *See* Schultz v. Texaco, Inc., 127 F. Supp. 2d 443 (S.D.N.Y. 2001) (involving employee suit claiming ERISA violation in benefit program exclusion following reclassification of employees as independent contractors); Herman v. Time Warner, Inc., 56 F. Supp. 2d 411 (S.D.N.Y. 1999) (involving lawsuit filed by the U.S. Department of Labor that claimed a violation of ERISA fiduciary duties in the misclassification of workers as temporary employees and independent contractors, thereby leading to their denial of benefit program participation rights). In addition to these cases, a series of lawsuits challenging benefit exclusions has been filed by Bendich, Stobaugh and Strong, P.C., the law firm that won the Microsoft case. Defendants include ARCO, the City of Bellevue, the State of Washington (for summer part-time instructors), King County and Los Angeles County. *See* Bendich, Stobaugh and Strong, P.C., *at* http://www.bs-s.com/index.html (last visited March 19, 2002); *see also,* Nancy Rivera Brooks, *Suit Raises Questions on Benefits for Temps, Labor: Class Action Accuses ARCO of Misclassifying Workers in the Last Decade to Avoid Having to Pay for Pensions and Health Care,* L.A. TIMES, June 25, 1999, at C1. The use of contingent employment labels to avoid providing benefits is not limited to domestic private sector employers. *See* Theo Francis, *World Bank's Temporary Employees Protest Institution's Policy on Pensions,* Wall St. J., March 7, 2002, at A8.

7. *Microsoft Settles Suits By Temporary Workers Disputing Labor Policy,* WALL ST. J., Dec. 13, 2000, at C10.

8. *See, e.g.,* Mark Berger, *The Contingent Employee Benefits Problem,* 32 IND. L. REV. 301 (1999); Richard J. Freddo, Comment, *Contingent Workers: A Full-Time Job for Employers, Benefit Plan Administrators and the Courts,* 52 SMU L. REV. 1817 (1999); Eileen Silverstein & Peter Goselin, *Intentionally Impermanent Employment and the Paradox of Productivity,* 26 STETSON L. REV. 1 (1996); Philip I. Hixon, Note, *Contingent Workers and ERISA: Should the Law Protect Workers With No Reasonable Pension Expectations?,* 25 OKLA. CITY U. L. REV. 667 (2000); Paul Kellogg, Note, *Independent Contractor or Employee:* Vizcaino v. Microsoft Corp., 35 HOUS. L. REV. 1775 (1999).

9. *Vizcaino I,* 97 F.3d at 1191.

10. At-will employees are subject to discharge at the discretion of the employer. *See, e.g.,* Skagerberg v. Blandin Paper Co., 266 N.W. 872 (Minn. 1936). The evolution of the at-

reason to believe that they would be let go, as long as the company needed their services and their performance met expectations.[11] Workers in this category received a variety of company-supported benefits, including: paid vacations, sick leave and holidays, short-term disability, group health and life insurance, a company-assisted section 401(k) retirement plan, and an employee stock purchase plan that gave them the opportunity to purchase Microsoft stock at discounted prices.[12] In addition, since Microsoft categorized them as employees, it was required to withhold income taxes due on their salaries and pay the employer's portion of contributions required for social security and unemployment insurance.[13]

In addition to its traditional workforce, with expectations of continuous employment and with a program of employee benefits supplementing established salaries, Microsoft maintained a second tier of workers. Individuals in the second tier category were given the title of "freelancer" and received compensation limited to payment for the services they

---

will employment rule is discussed in Jay M. Feinman, *The Development of the Employment at Will Rule,* 20 AM. J. LEGAL HIST. 118 (1976). The rule does not apply where specific statutory restrictions exist, such as those barring terminations that violate anti-discrimination laws. *E.g.,* Civil Rights Act of 1964, Title VII, 42 U.S.C. § 2000e-2 (1994); Americans With Disabilities Act, 42 U.S.C. § 12112 (1994). In addition, many jurisdictions have adopted the principle that employers may not terminate at-will employees for reasons that violate public policy. *E.g.,* Knight v. Am. Guard & Alert, Inc., 714 P.2d 788 (Alaska 1986); Boyle v. Vista Eyewear, Inc., 700 S.W.2d 859 (Mo. Ct. App. 1985); Sabine Pilot Serv., Inc. v. Havck, 687 S.W.2d. 733 (Tex. 1985). *See generally* HENRY H. PERRITT, JR., EMPLOYEE DISMISSAL LAW AND PRACTICE (3d ed. 1992); Lawrence E. Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power,* 67 COLUM. L. REV. 1404 (1967).

11. As Professor Paul Weiler has observed:

> The standard expectation in the real world of work is that the employee will keep his job unless he does something wrong—in the sense of some specific misconduct or a general pattern of poor performance—and as a consequence forfeits the position. Indeed, a further feature of the social mores at work is that even if an employee does something wrong—for example, if he takes a day off without a legitimate reason—it will not cost him his job immediately; he will be dismissed only if the bad act is part of a broader pattern of unsuitable behavior which has not been corrected by the employer with less severe disciplinary measures.

PAUL C. WEILER, GOVERNING THE WORK PLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW 52 (1990).

12. *Vizcaino I,* 97 F.3d at 1189, 1191.

13. In addition to withholding income taxes from their employees, employers are required by federal law to pay the employer's portion of the Federal Insurance Contribution Act tax (FICA) and the payroll taxes due under the Federal Unemployment Tax Act (FUTA). *See* Federal Insurance Contributions Act (FICA), I.R.C. §§ 3101-3128 (1994 & Supp. 2001); Federal Unemployment Tax Act (FUTA), I.R.C. §§ 3301-3311 (1994 & Supp. 2001).

performed.[14] From the company's perspective, the freelancers were independent contractors rather than Microsoft employees.[15] As such, and pursuant to Microsoft's personnel policy, they were excluded from participation in all company benefit programs, and were required to handle their own estimated tax payments and social security contributions.[16]

Ultimately, however, the Microsoft system unraveled when the company was found, in an Internal Revenue Service (IRS) audit, to have misclassified its freelance workforce as independent contractors.[17] Indeed, the misclassification was so clear that Microsoft offered no challenge to the IRS conclusion that the freelancers were actually Microsoft employees.[18] As a result, the company was forced to restructure its personnel system.[19] This had immediate tax consequences because the company had not been withholding income taxes from payments made to the freelancers, nor had it paid the employer's portion of the social security and unemployment insurance payroll taxes due on the money the freelancers had earned.[20] In addition to the task of straightening out the withholding and social security tax problems it had created, Microsoft also found itself defending a class action lawsuit challenging the exclusion of the freelance workforce from the right to participate in the company's benefit programs. The basis of the freelancers' claim was that the Microsoft benefit programs were established for company employees, and the conclusion of the IRS audit, which the company accepted, was that the freelancers belonged in that category.[21]

---

14. *Vizcaino I*, 97 F.3d at 1190 (describing payment of freelancers through the Microsoft accounts receivable department after submission of invoices, rather than through the payroll department).

15. *Id.* The freelancers signed Independent Contractor/Freelancer Information documents acknowledging their independent contractor status. *Id.*

16. *Id.* The documents the freelancers signed stated that they were responsible to pay for their own insurance and benefits. *Id.*

17. *Id.*

18. *Id.* at 1190 & n.1, 1191.

19. Some freelancers were given the option of becoming regular Microsoft employees. *Id.* at 1191. Others were given the choice of either continuing to perform services for Microsoft through a temporary employment agency or terminating their employment relationship with the company. *Id.* Microsoft also instituted a policy whereby all temporary workers could not work for the company for more than one year without taking a 100-day hiatus. *Microsoft Says Temps Must Take a Hiatus After Working a Year*, WALL ST. J., Feb. 22, 2000, at A32.

20. *Vizciano I*, 97 F.3d at 1191 & n.2.

21. In pursuing their class action lawsuit, the freelancers sought benefits from Microsoft's 401(k) retirement and employee stock purchase programs. *Id.* at 1191. The former was made available by Microsoft for employees over eighteen with at least six months of

Microsoft's utilization of a two-tier employment system, which it continues to employ in a restructured fashion,[22] is far from unique. An increasing number of employers are making use of alternative workforce systems to meet their production needs. Typically these involve supplementing a core of traditional full-time workers with a ring of contingent employees[23] to whom no commitments are made other than payment for services rendered.[24] Such contingent workers[25] have no expectation of indefinite or continuous employment, and are generally excluded from whatever benefit programs the company may provide.[26]

---

service. *Id.* at 1192. The stock purchase plan required that its eligibility provisions were to be interpreted to qualify the plan under section 423 of the Internal Revenue Code, which provides that stock options must be granted to "all employees" of the company. *Id.* at 1197.

22. *See supra* note 19. However, the Ninth Circuit Court of Appeals observed that former freelancers who accepted employment at Microsoft through a temporary employment agency "noticed little change in the terms or conditions of their employment; they continued working the same hours on the same projects and under the same supervisors." *Vizcaino I*, 97 F.3d at 1191. More recently, Microsoft announced that its temporary employees would not be allowed to work for the company for more than one year without a 100 day hiatus. *Microsoft Says Temps Must Take a Hiatus After Working a Year*, *supra* note 19.

23. The core-ring model is described in STANLEY D. NOLLEN & HELEN AXEL, MANAGING CONTINGENT WORKERS: HOW TO REAP THE BENEFITS AND REDUCE THE RISKS 41-44 (1996). *See also* PAUL OSTERMAN, EMPLOYMENT FUTURES: REORGANIZATION, DISLOCATION, AND PUBLIC POLICY 85 (1988).

24. In its survey of contingent employment, the Bureau of Labor Statistics defined the category as including "those who do not have an explicit or implicit contract for ongoing employment." BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONTINGENT AND ALTERNATIVE EMPLOYMENT ARRANGEMENTS, FEBRUARY 2001, *available at* http://stats.bls.gov/news.release/conemp.nr0.htm (last visited March 19, 2002) [hereinafter BLS CONTINGENT EMP. REPORT]. Elsewhere, contingent employees have been defined as those who "have little or no attachment to the company at which they work . . . . They have neither an explicit nor implicit contract for continuing employment." NOLLEN & AXEL, *supra* note 23, at 5.

25. Contingent employment relationships can involve a variety of work arrangements, including the use of internal contract workers, temporary or leased staff, and independent contractors. *See generally* ROBERT L. ARONSON, SELF-EMPLOYMENT: A LABOR MARKET PERSPECTIVE (1991); EDWARD A. LENZ, CO-EMPLOYMENT: EMPLOYER LIABILITY ISSUES IN THIRD-PARTY STAFFING ARRANGEMENTS (3d ed. 1997); JACKIE K. ROGERS, TEMPS: THE MANY FACES OF THE CHANGING WORKPLACE (2000).

26. BENNETT HARRISON & BARRY BLUESTONE, THE GREAT U-TURN: CORPORATE RESTRUCTURING AND THE POLARIZING OF AMERICA 46 (1988); NOLLEN & AXEL, *supra* note 23, at 63-64; *Contingent Workers Unfairly Deprived of Benefits, Job Security, Senate Panel Told*, DAILY LAB REP. (Bureau of Nat'l Affairs), June 16, 1993, LEXIS 1993 DLR 114 d11. The February 2001 survey by the Bureau of Labor Statistics estimated that between 55.8% and 63.6% of contingent workers had health insurance compared with 82.5% of noncontingent

Many employers believe that such a system provides greater production flexibility and efficiency because it permits firms to expand and contract more easily in response to market conditions.[27] However, employer eagerness to avoid hiring traditional employees who expect continuous employment and workplace benefits may lead them to misclassify their workers as non-employees, either purposefully or accidentally.[28] In an effort to establish a contingent workforce of independent contractors, or part-time, temporary or leased workers, employers may seize upon labels instead of closely analyzing the workplace setting they have created.

The increasing use of two-tier employment systems consisting of traditional and contingent labor, as illustrated by Microsoft's experience, is fraught with danger. A lack of care in the design of the workplace environment can easily produce a personnel system that fails to incorporate the elements required to avoid the creation of an employer-employee relationship. If discovered, the result can be substantial financial liability. Even if properly structured, however, there are serious questions that arise from the successful creation of a two-tier personnel system that satisfies existing legal requirements. In such cases, the end product sought by the employer is to create a disfavored second-tier group of service providers

---

workers, and that between 10.8% and 21.7% of contingent workers were eligible for employer-provided pension plans as compared to 51.8% of non-contingent workers. BLS CONTINGENT EMP. REPORT, *supra* note 24, at Table 9.

27. This was the most commonly cited reason for contingent employee utilization reported in an Upjohn Institute survey. SUSAN N. HOUSEMAN & ANNE E. POLIVKA, THE IMPLICATIONS OF FLEXIBLE STAFFING ARRANGEMENTS FOR JOB STABILITY 7 (W.E. Upjohn Inst. for Employment Research, Staff Working Paper No. 99-056, Feb. 1998, rev. May 1999), *available at* http://www.upjohninst.org/publications/wp/99-56.pdf (last visited March 19, 2002).

28. Critics of existing standards maintain that they are unclear. *E.g., Tax Issues Impacting Small Business: Hearing Before the Senate Committee on Small Business,* 104th Cong. 83, 85 (1995) (statement of Senator Don Nickels, observing that "Congress has amazingly failed to give workers or businesses adequate guidance as to who is an employee and who is an independent contractor," and that the Treasury Department recognizes that "reasonable persons may differ as to the correct classification" under the common law test). Critics of business, in contrast, complain about the fact that "[f]ake independent contractor scams are rampant throughout the low-wage workforce sectors." Jonathan P. Hiatt, *Policy Issues Concerning the Contingent Workforce,* 52 WASH. & LEE L. REV. 739, 749 (1995) (citing a Coopers & Lybrand study); *see also Tax Issues Impacting Small Business: Hearing Before the Senate Committee on Small Business,* 104th Cong., 1st Sess. 56, 282 (1995) (Coalition for Fair Worker Classification, *Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers,* observing that "[s]tudies performed by the IRS and GAO have indicated that there is a significant segment of employers which may deliberately treat their employees as independent contractors").

who lack the job protections and benefits that are among the central goals of most workers.[29] Why should the legal system protect such an arrangement?

This article will address both the legal and public policy implications of utilizing two-tier employment systems that deny some workers the right to participate in employee benefit programs. Microsoft's freelancer system and the response of the courts to the class action challenging their exclusion from company benefit programs will be considered in the section that follows. Thereafter, this article will explore the use of independent contractor agreements and benefit plan eligibility criteria to restrict benefit program coverage. Finally, this article concludes with recommendations for how the legal system should respond to this problem.

II. STRUCTURING A TWO-TIER EMPLOYMENT SYSTEM

The Ninth Circuit Court of Appeals described Microsoft's personnel system as an example of the way large corporations use contingent employees "as a means of avoiding payment of employee benefits, and thereby increasing their profits."[30] That language was a clear sign of the court's hostility to Microsoft's employment structure. The implication of the court's statement was that the company's personnel system was a subterfuge designed to achieve financial ends rather than a meaningful structuring of the workforce dictated by production needs. As a result, there was no reason to give Microsoft the benefit of the doubt in assessing whether the company had successfully avoided its benefit program and tax responsibilities.[31]

---

29. A study by Aon Consulting observed that its survey data "suggest that employees are looking for increased benefits offerings to keep them committed. The study results show that the benefits package is important to employees. When asked if they would rather receive an increase in pay or greater choice of benefits, 56% opted for benefits." AON CONSULTING, INC., UNITED STATES @WORK: AON CONSULTING WORKFORCE COMMITMENT REPORT 2000 16 (2000).

30. Vizcaino I., 97 F.3d 1187, 1189 (9th Cir. 1996).

31. Specifically, Microsoft was denied the benefit of the doubt when the court applied the *contra proferentem* doctrine, which had the effect of interpreting the benefit program's governing plan language against the company since it had drafted the applicable restrictions. *Id.* at 1194, 1196. Subsequently, however, the en banc opinion of the Ninth Circuit Court of Appeals remanded the interpretation of the SPP plan to the benefit program administrator rather than affirming the interpretation of the relevant plan language by the Ninth Circuit Court of Appeals panel. Vizcaino II., 120 F.3d 1006, 1013-15 (9th Cir. 1997) (en banc), *cert. denied*, 522 U.S. 1098 (1998). In effect, this meant giving the company the benefit of the doubt since the plan administrator could be expected to rule in favor of Microsoft's interpretation of the plan, and any subsequent court review would be based upon an abuse of discretion standard.

The court described Microsoft's core of permanent employees as having a wide variety of typical employee benefits. These specifically included vacations, sick leave, holidays, short-term disability, group health and life insurance, and a pension program.[32] The litigation, however, only concerned the right to participate in Microsoft's Savings Plus Plan (SPP),[33] a 401(k) retirement program, and its Employee Stock Purchase Plan (ESPP).[34] Participation in both plans was limited to the company's regular employees. From the company's perspective, the limitation meant that the members of the freelancer workforce were excluded.

Microsoft used its non-regular freelancer workforce to supplement its core of regular employees, with some freelancers working for significant periods of time. In fact, seven of the eight original plaintiffs had worked for the company as freelancers for at least two years, while the eighth had worked for more than a year.[35] Their tasks included such functions as software testing, production editing, proofreading, formatting and indexing.[36] Significantly, according to the court, the company "fully integrated plaintiffs into its workforce: they often worked on teams along with regular employees, sharing the same supervisors, performing identical functions, and working the same core hours."[37] Additionally, as on-site members of the workforce, they were given card keys to obtain admittance and used company office equipment and supplies.[38]

For the most part, Microsoft's contingent freelance workforce did not appear to be distinguishable from its regular core of employees. Nevertheless, the company did attempt to create some differences between the two groups. As the court noted, each group had different color badges, different e-mail addresses, and different orientation programs.[39] Furthermore, the freelancers were not permitted to assign work to others, did not receive invitations to official company functions, and were not paid

---

32. *Vizcaino I*, 97 F.3d at 1189.

33. The SPP was a deferred salary plan under I.R.C. section 401(k), which allowed employees to defer income tax on up to 15% of their annual income, with the company matching 50% of the employee's contribution up to a maximum of 3% of the employee's annual salary. *Id.* at 1191.

34. The ESPP plan allowed employees to purchase stock at 85% of fair market value on a determined date, as long as the share value did not exceed 10% of the employee's annual compensation. *Id.* at 1191.

35. *Id.* at 1190.

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

overtime wages.[40] In fact, they were not paid through the company's payroll department at all, but were instead compensated through the company's accounts receivable department after submitting invoices for the hours they worked on company projects.[41] Significantly, however, the distinctions created by Microsoft appear to have been more formal than substantive. The description of the court made it seem as though outside observers would not have been able to tell the two groups apart at the work site except for their different color badges.

Why would a company like Microsoft make such an effort to separate two groups within its workforce even though, based upon the work they performed and their environment within the workplace, they were largely indistinguishable? Certainly one possible answer is the explanation offered by the court in its opinion. Indeed, support for the view that the structure was set up to minimize costs and maximize profits is demonstrated by the fact that the freelance workforce was excluded from the right to participate in the entire series of company benefits made available to members of the regular workforce.[42] Microsoft also attempted to structure the arrangement in a way that would eliminate the need for it to make social security and unemployment insurance contributions on behalf of its freelance workers.[43]

Microsoft attempted to insure the effectiveness of its two-tier structure by requiring its freelance workforce to sign independent contractor agreements. These contained acknowledgments of freelancer responsibility for withholding taxes and social security contributions, as well as exclusion from all benefits.[44] The provision governing benefits emphasized this point by specifically stating that "as an Independent Contractor to Microsoft, you are self-employed and are responsible to pay all your own insurance and

40. *Id.*

41. *Id.*

42. It must be conceded that excluding freelance workers from benefit programs does not conclusively establish that Microsoft reduced its costs by creating a two-tier workplace structure. It is theoretically possible that there were no cost savings, a result that would follow if freelancers were paid a higher rate than members of the regular workforce, with the difference being greater than the cost of all the benefits from which they were excluded. No figures, however, were offered to support this conclusion.

43. Employer contributions for the social security and unemployment insurance programs are only required for employees, with independent contractors not being covered by either program. *See* Federal Insurance Contribution Act (FICA), I.R.C. §§ 3101-3128 (1994 & Supp. 2000); Federal Unemployment Tax Act (FUTA), I.R.C. §§ 3301-3311 (1994 & Supp. 2000). *See generally* Susan Schwochau, Note, *Identifying an Independent Contractor for Tax Purposes: Can Clarity and Fairness Be Achieved,* 84 IOWA L. REV. 163 (1998).

44. *Vizcaino I*, 97 F.3d at 1190.

benefits."[45] Thus, not only did Microsoft intend to relieve itself of the obligation to provide benefits to its freelance workers, it also made acknowledgment of an independent contractor relationship and the exclusion from benefit program participation rights a condition of employment as a Microsoft freelancer.

While reducing costs was a likely result, if not the prime objective, of the Microsoft freelance system, such two-tier arrangements are often justified by employers as a method for increasing flexibility.[46] The theory is that non-traditional workers can be added and dropped as production needs dictate. This is particularly true for independent contractors, who are normally thought of as being brought in for specific tasks that they can perform on their own, and who are then free to hire themselves out to other employers.[47] This would be the kind of system one would expect an employer to use to handle such discrete needs as construction projects or the installation of new machinery at the worksite. Microsoft, however, was not using its freelancer workforce in the traditional independent contractor fashion. Instead, they were employed to perform tasks no different from those assigned to Microsoft's regular workforce. Moreover, their assignments ran for substantial periods of time, some in excess of two years.

---

45. *Id.*

46. "Workforce flexibility is a major reason organizations use contingent workers because adjustments in labor hours can be made quickly as demand fluctuates." Stanley D. Nollen & Helen Axel, *Benefits and Costs to Employers, in* CONTINGENT WORK: AMERICAN EMPLOYMENT RELATIONS IN TRANSITION 126, 130 (Kathleen Barker and Kathleen Christensen eds., 1998). Another researcher observed: "Traditional reasons concerning the need to accommodate fluctuations in workload or absences in staff are the most commonly cited reasons for using all types of flexible staffing arrangements. Many employers also use agency temporaries and part-time workers to screen candidates for regular positions. Finally, savings on benefits costs is an important factor determining employers' use of flexible staffing arrangements." SUSAN N. HOUSEMAN, WHY EMPLOYERS USE FLEXIBLE STAFFING ARRANGEMENTS: EVIDENCE FROM AN ESTABLISHMENT SURVEY, abstract, (W.E. Upjohn Institute for Employment Research Staff Working Paper No. 01-67, June. 1998, 2nd rev. Oct., 2000), *available at* http://www.upjohninst.org/publications/wp/01-67.pdf (last visited March 19, 2002).

47. The ability of a worker to sell his services to others is a factor used by the Internal Revenue Service in making the employee and/or independent contractor classification. Rev. Rul. 87-41, 1987-1 C.B. 296. *See* Donovan v. DialAmerica Mktg., Inc., 757 F.2d 1376, 1385 (3d Cir. 1985) (finding home researchers to be employees rather than independent contractors, the court considered that the "home researchers did not transfer their services from place to place, as do independent contractors").

It is no wonder that Microsoft's freelancers were given the label "permatemps."[48]

Whether or not Microsoft's freelancers were properly labeled as independent contractors, however, is a separate question from whether the company was creating a personnel system that would provide it with greater flexibility to increase or decrease its workforce in response to business needs. The fact is that subject to narrow exceptions, even regular employees do not have any legally enforceable guarantees of continuing employment under the at-will employment rule.[49] Assuming that the company's core workforce was not given contractual tenure, they were as legally disposable as independent contractors or any other contingent employee group. Even employees who have just cause protection against termination can be released if they engage in misconduct or if there is no longer any work for them to perform.[50]

If flexibility is relevant in the use of two-tier employment systems, it must be because regular employees are not that easily terminated despite the absence of a legally protectable interest in their positions. That is because even if an employee holds his job at-will, there is nevertheless a subtle and implicit understanding between the employer and employee that employment will be continuous as long as work is available and the employee performs satisfactorily.[51] If this is an accurate characterization of an employer's regular workforce, then there does appear to be added flexibility in dealing

---

48. *E.g.*, John Cook, *Microsoft Limits Amount of Time Temps Can Work: New Policy Could End Its 'Prematemp' Problem*, SEATTLE POST-INTELLIGENCER, Feb. 19, 2000, at B3; *Microsoft Changes 'Permatemps' Policy: Lawsuits, Bad Publicity Prompt Shift*, HOUSTON CHRONICLE, Feb. 21, 2000, at 7.

49. *See* sources cited *supra* note 10.

50. Layoffs due to lack of work are uniformly upheld in labor arbitration proceedings, as long as procedural requirements, such as bumping rights, are respected. ELKOURI & ELKOURI, HOW ARBITRATION WORKS 772-75 (Marlin M. Volz & Edward P. Goggin eds., 5th ed. 1997); Murphy Oil U.S.A., Inc., 86 Lab. Arb. Rep. (BNA) 54 (1985) (Allen, Arb.). Misconduct is also recognized as representing just cause for termination. ELKOURI & ELKOURI, *supra*, at 884-968.

51. *See* WEILER, *supra* note 11. Research indicates that most workers believe that they have far more legal protection against termination than the law actually affords them. Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105, 133-46 (1997). However, the increasing willingness of employers to disavow any commitment to employment security has led to the suggestion that employers should assume obligations of training and networking in order to secure some measure of employee loyalty. Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace For Labor and Employment Law*, 48 UCLA L. REV. 519 (2001).

with non-regular workers since they can be told that they have no expectation of continuity. They are, in other words, *really* at-will employees.

Cost savings and flexibility would thus appear to be the major objectives served by the creation of a two-tier employment system. In Microsoft's case, it knew it needed a complement of workers upon whom it could rely, and these were given traditional jobs with at least the likelihood of continuity and the certainty of specified benefits. Beyond that point, Microsoft was unwilling to make any guarantees, and therefore it created a category of freelance workers who were told to expect nothing more than payment for services rendered for as long as Microsoft needed or wanted their help. As a result, the Microsoft workplace became a combination of regular workers with expectations of continuous employment and the right to participate in the company's benefit programs, the haves, alongside the freelancer have-nots.

The freelancers, of course, knew where they stood. They were specifically informed in the independent contractor agreements what their status would be as part of the Microsoft workforce.[52] While it was clear that what Microsoft was trying to do was to attempt to create a two-tier employment system for its workforce, however, and while the freelancers were made aware of their status, this was not the end of the legal analysis. It was still necessary to determine whether Microsoft's personnel structure was entitled to legal protection. This was an issue both with respect to freelancers who might become dissatisfied with their contingent employment status, as well as with respect to the government whose interests could be adversely affected by the arrangement.[53] In the end, Microsoft found that neither the freelancers nor the government were bound by the system it had attempted to create.

---

52. The agreements signed by the freelancers stated that they were independent contractors and that they would be responsible for all taxes, social security payments and other benefits. Vizcaino I., 97 F.3d 1187, 1190 (9th Cir. 1996).

53. IRS studies indicate that independent contractors "are more likely to underreport income and/or overstate expenses." Coalition for Fair Worker Classification, *Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers,* in *Tax Issues Impacting Small Business: Hearing Before the Senate Comm. on Small Business,* 104th Cong. 261 (1995). The potential loss of tax revenue represents a governmental interest distinct from that of the misclassified worker. According to General Accounting Office estimates, $1.6 billion was lost to the U.S. Treasury in social security, unemployment and income tax collections as a result of worker misclassification in 1994. *Employment Classification Issues: Hearings Before the Oversight Subcomm. of the House Comm. on Ways & Means,* 104th Cong. 162 (1997) (statement of GAO Associate Director Natwar M. Gandhi).

Not surprisingly, efforts by employers to define relationships with service providers in a way that circumvents relevant tax and labor protective legislation have not proven to be effective against governmental agencies seeking to enforce legislative policy.[54] The developments in the Microsoft litigation provide an illustration of this principle. Indeed, the Microsoft litigation began with an IRS audit of Microsoft's employment records to assess the company's tax law compliance. What the IRS concluded was that Microsoft had improperly classified its freelancer workforce as independent contractors rather than as Microsoft employees.[55] Since the freelancers were not classified as employees, Microsoft had not withheld their income taxes and did not contribute the employer's portion of their Federal Insurance Contribution Act (FICA) tax. However, Microsoft responded to the audit by undoing the damage. Specifically, it agreed to pay overdue employer withholding taxes and took steps to allow the freelancers to recover the employer's portion of the FICA taxes they had paid.[56]

Microsoft's misclassification of its freelancers as independent contractors is far from a unique event. Many employers have come to recognize the financial advantages of avoiding the creation of employment relationships and have taken steps to restructure their personnel systems accordingly. Often, however, this is achieved by simply attaching the label of independent contractor to their workforce without making any substantive changes in the way work is performed. This improperly shifts the burden of FICA payments and the responsibility for collecting and remitting taxes from the employer to the worker. The resulting system is one that the IRS has found to be a less reliable method for the remittance of taxes due with a resulting loss of revenue to the government.[57] The IRS attempts to audit employers to detect such misclassifications, but, obviously, it cannot catch everyone.[58]

---

54. *E.g.*, Breaux & Daigle, Inc., v. United States, 900 F.2d 49 (5th Cir. 1990) (unemployment and social security taxes); Donovan v. DialAmerica Mktg., Inc., 757 F.2d 1376 (3d Cir. 1985) (Fair Labor Standards Act); 303 W. 42nd St. Enters. v. IRS, 916 F. Supp. 349 (S.D.N.Y. 1996) (employment taxes).

55. *Vizcaino I*, 97 F.3d at 1190. The IRS uses common law standards to determine employee status. They are explained in a publicly-available training manual. INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, EMPLOYEE OR INDEPENDENT CONTRACTOR? (1996).

56. *Vizcaino I*, 97 F.3d at 1190-91.

57. *See supra* note 52.

58. Recently the IRS issued a new audit technique guide addressing the problem of employers hiring their former employees as consultants and thereby attempting to avoid the duty to collect withholding taxes, as well as Social Security and Medicare contributions. David Cay Johnston, *I.R.S. Guide Focuses on Consultants*, N.Y. TIMES, June 21, 2001, at C5.

There is certainly nothing illegal about employers attempting to take advantage of the right to avoid employment status in their relationships with service providers, with all the tax advantages that follow. More than relabeling is required, however. The IRS, with judicial backing, has employed a twenty-factor test designed to determine whether the employer's workforce is comprised of traditional common law employees or non-employee independent contractors.[59] At its core, the factors seek to assess whether the employer has retained sufficient control over the workforce to warrant application of the common law employee classification. Employers such as Microsoft, who simply relabel their workforce as independent contractors without surrendering the right of control, have not effectively severed the employment relationship, and are therefore not entitled to avoid the tax responsibilities associated with employer status.

In some borderline cases, classifying service providers as employees or independent contractors may be difficult.[60] It seems clear, however, that Microsoft did not relinquish indicia of control over its freelancer workforce in any meaningful way. The Microsoft freelancers were integrated with the company's regular employees, subject to common supervision, and largely indistinguishable, other than by the different color badges issued to them. Perhaps the clarity of the case is what led Microsoft not to challenge the IRS conclusion that the freelancers were employees rather than independent contractors.

It is nevertheless true that the use of the common law right of control test as the standard for evaluating independent contractor relationships has itself become a source of controversy. Much of the array of labor protective legislation in the United States, which currently is triggered by a finding of traditional common law employment status, also would have applicability to those in non-traditional work arrangements. This has suggested to some the appropriateness of extending the reach of such legislation to those who may not satisfy the traditional common law standard.

---

59. Rev. Rul. 87-41, 1987-1 C.B. 296. Included are such items as whether instructions are given to the worker, location of the work on the company's premises, investment required by the worker, worker opportunities for profit and loss, and the continuity of the relationship. *See generally* Myra H. Barron, *Who's an Independent Contractor? Who's an Employee?*, 14 LAB. LAW. 457 (1999).

60. IRS standards have been challenged as vague and conflicting. *See, e.g., Tax Issues Impacting Small Business: Hearing Before the Senate Comm. on Small Business*, 104th Cong. 83, 85 (1995) (statement of Senator Don Nickels observing that "Congress has amazingly failed to give workers or businesses adequate guidance as to who is an employee and who is an independent contractor," and that the Treasury Department recognizes that "reasonable persons may differ as to the correct classification" required by common law standards).

Efforts to move in the direction of extending workplace coverage beyond traditional common law employees are not new. During the 1940's, the Supreme Court considered whether newsboys were covered under the National Labor Relations Act in *NLRB v. Hearst Publications, Inc.*[61] In deciding upon coverage, the Court looked to the economic realities of the relationship rather than the formal structure the employer had created. Concluding that Congress had a broader view of the applicability of the Act beyond traditional master and servant relationships,[62] the Court found that the National Labor Relations Board had jurisdiction because the newsboys seeking representation were "subject, as a matter of economic fact, to the evils the statute was designed to eradicate."[63]

However, the years since *Hearst Publications* have not been kind to the economic realities standard. Initially, Congress rejected the Court's interpretation of the National Labor Relations Act by amending the legislation to provide for the specific exclusion of independent contractors.[64] More recently, the Court itself turned its back on the economic realities analysis. It held that use of the term "employee" in ERISA incorporates traditional common law analysis and that this should be the approach used in other statutes containing similar language.[65] Where the controlling statutory provision indicates an intent to widen coverage, a different analysis may apply,[66] but this is not typically the case in labor and employment law statutes. Yet, despite restrictive court rulings, there continues to be interest in the expansion of the right of control test, including the formal recognition by the Commission on the Future of Worker-Management Relations, known popularly as the Dunlop Commission, of the need for a single economic reality standard to be applied generally in determining coverage under labor and employment law

---

61. 322 U.S. 111 (1944).

62. *Id.* at 124.

63. *Id.* at 127.

64. The amendment was contained in the Taft-Hartley Act of 1947. Labor Management Relations (Taft-Hartley) Act, ch. 120, § 101(2)(3), 61 Stat. 136, 137-38 (1947) (codified at 29 U.S.C. § 152(3) (1994)).

65. Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1962).

66. *Id.* at 326. The Supreme Court noted in *Darden* that the definition of "employee" in the Fair Labor Standards Act includes not merely the requirement that the "individual [be] employed by an employer" but also expansively defines the term "employ" to include "suffer or permit to work." *Id.* To the Court this meant that some "who might not qualify as such under a strict application of traditional agency law principles," might still be covered under the act. *Id.*

statutes.[67] For the time being, however, structuring a personnel system that avoids indicia of control over the service provider's workforce will permit an employer to avoid many of the regulations aimed at traditional employment relationships.

III. MICROSOFT FREELANCERS IN THE NINTH CIRCUIT COURT OF APPEALS

Even if third parties, particularly the government, are not bound by the independent contractor label an employer assigns to the workforce, the same need not be true for the workers themselves. Arguably, if the employer specifies the commitments it is prepared to make, and the service providers are made aware of exactly what they are, that should be sufficient to constitute a binding agreement between the two. Where the employer is insistent on the terms that will apply and the worker is unable to negotiate for a better arrangement, the result may be a "take it or leave it" deal; but at least the service provider has the option of securing other employment. Courts may still seek to regulate the process by which the agreement is made to insure full and accurate disclosure, but this would be different from barring the arrangement entirely.

The issue arose in the Microsoft litigation because the plaintiffs had been required to sign independent contractor agreements specifying that Microsoft assumed no liability or responsibility for providing benefits. This presumably would have been sufficient to cover any claim by freelancers for a right to participate in both the Microsoft retirement (SPP), and stock purchase (ESPP) plans. Both were clearly benefit plans, and the independent contractor agreements the freelancers executed were unambiguous in stating that Microsoft would not permit any signatory to participate in either.

Determining whether a service provider similar to the Microsoft freelancers should be bound by an independent contractor agreement that clearly states that the signer is excluded from participation in any company benefit program must begin with consideration of the employment contract itself. In Microsoft's case the employment contract seemed to portray clearly the benefit consequences of signing on as a Microsoft freelancer. The

---

67. THE DUNLOP COMM'N ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS, FINAL REPORT 37 (1994). According to the commission, independent contractor status should be based upon a judgment that the workers are entrepreneurs who perform services for clients and bear the economic risk of gain or loss. The commission distinguished workers who are economically dependent on the entity that pays them, a standard normally including low wage and low skill personnel. *Id.* at 38-39.

language stated that freelancers would not participate in the company's benefit programs, and did so in no uncertain terms.

However, at the same time Microsoft was informing its freelancer workforce that they would not be eligible for benefits, it was also communicating to regular and non-regular employees what criteria would have to be satisfied before a member of the workforce would be eligible for participation in both the SPP and ESPP plans. The relevant language of the SPP document stated that all employees over the age of eighteen who had worked more than six months for the company would be eligible to participate, and that "employee" meant "any common-law employee who receive[d] renumeration for personal services rendered to the employer and who [was] on the United States payroll of the employer."[68] The ESPP plan contained language indicating the company's intent to have the stock purchase program qualify under section 423 of the Internal Revenue Code, and that plan language was to be "construed so as to extend and limit participation in a manner consistent with the requirements of that Section of the Code."[69] Thus, despite what appeared to be a clear statement of freelancer benefit plan ineligibility as a result of the language contained in the employment agreements, the possibility of a conflicting result arose from the qualifying provisions of the benefit plan documents. These provisions extended benefit program participation rights to employees, a category ultimately determined to include the freelancers as a result of the IRS audit that rejected Microsoft's effort to classify the freelancers as independent contractors.

The Ninth Circuit Court of Appeals panel decision, relying on Washington state law, concluded that it was required to construe the ESPP benefit plan language according to "the reasonable meaning of a person's words and acts."[70] That language called for an interpretation of ESPP eligibility criteria in a manner consistent with the requirements of section 423 of the Internal Revenue Code, which, in turn, limits favorable tax treatment for stock purchase programs to those that grant purchase rights to all of the employer's employees.[71] Additionally, pursuant to section 423, "employees" has been construed to refer to common law employees. Since the freelancers had been determined to be common law employees by the IRS, and since Microsoft had not challenged that determination, they were therefore eligible to participate in the program.

68. Vizcaino I., 97 F.3d 1187, 1192 (9th Cir. 1996).

69. *Id.* at 1197.

70. *Id.* (quoting Multi Care Med. Ctr. v. DSHS, 790 P.2d 124, 133 (Wash. 1990)).

71. I.R.C. § 423(b)(4) (1994 & Supp. 2000).

Not surprisingly, Microsoft defended on the grounds that the freelancers had signed contracts that rendered them ineligible to participate in the ESPP plan, thus presenting a conflict between the independent contractor agreements and the provisions of the ESPP trust document. Recognizing that exclusion of the freelancers would jeopardize the plan's qualified tax status, the court concluded that this concern trumped the contrary result that the independent contractor agreements would have produced. Additionally, however, the court observed that the two instruments could be interpreted as not being inconsistent because the independent contractor agreement's statement that employees would be responsible for their own benefits did not necessarily bar participation in the stock purchase plan, since the freelancers would have to pay for stock purchases themselves under the terms of the program.[72] Finally, the court rejected the defense that the freelancers were not entitled to claim the right to participate in the plan because its terms were never communicated to them and they were thus unaware of the relevant provisions. The court's response was that under Washington state law, it was sufficient that Microsoft published the program, even if the plaintiffs were unaware of the specific details.[73]

When the ESPP plan was subjected to en banc review by the Ninth Circuit Court of Appeals, the majority opinion produced the same result.[74] In the court's view, the plan "was created and offered to all employees, the [w]orkers knew of it, even if they were not aware of its precise terms, and their labor gave them a right to participate in it."[75] The language contained in the independent contractor agreements was not enough to produce a different conclusion.

Microsoft's SPP plan provided coverage for employees over eighteen who had more than six months of service, and who fit the characteristic of being common law employees on the company's United States payroll. The Ninth Circuit Court of Appeals panel noted that the age and length of service factors were not at issue, and that the company conceded that the plaintiffs were common law employees who provided services to the company.[76]

---

72. *Vizcaino I*, 97 F.3d at 1198. It could also be argued, however, that the stock purchase plan was a company benefit since shares were made available at below-market rates.

73. *Id.* at 1199 (citing Dangott v. ASG Indus., Inc., 558 P.2d 379, 382 (Okla. 1976)). The court concluded that Washington would adopt the same approach if presented with the issue. *Id.*

74. Vizcaino II., 120 F.3d 1006, 1014-15 (9th Cir. 1997), *cert denied*, 522 U.S. 1098 (1998).

75. *Id.* at 1014.

76. *Vizcaino I*, 97 F.3d at 1192-93.

Thus, the only contested issue was whether the plaintiffs were on the company's United States payroll. Microsoft argued that the freelancers did not fit plan eligibility standards since they were not paid through the company's payroll department, while the freelancers claimed that the only requirement was that they be paid by the company from United States sources. Using a de novo review standard[77] and applying the principle of contra proferentum, which calls for the construction of ambiguous provisions against the drafter of a contested document,[78] the court concluded that the freelancers were eligible to participate under the terms of SPP plan.[79]

The fact that the SPP plan could be construed to include the freelancers did not alter the fact that the freelancers had also signed agreements stating that they were independent contractors and responsible for their own benefits. Clearly, the terms of the individual agreements were inconsistent with the eligibility provisions of the plan. Whichever document took precedence would ultimately determine benefit program eligibility.

The problem with the independent contractor agreements, of course, was that they were inaccurate. As the IRS concluded and as Microsoft conceded, the freelancers were not independent contractors, but rather common law employees. On the other hand, however, the statements in the independent contractor agreements clearly provided that the freelancers were responsible for their own benefits. The court could have chosen to recognize the benefit language in the independent contractor agreements, while ignoring the misclassification statement they contained. In the end, however, that choice was rejected.

The en banc opinion of the Ninth Circuit Court of Appeals recognized that Microsoft either made a mistake in calling the freelancers independent contractors, or intentionally misclassified them.[80] Finding no evidence that the officers of Microsoft intentionally sought to evade the law, the court concluded that Microsoft's actions were simply mistaken.[81] The en banc ruling viewed the contract not as a statement that the freelancers were

---

77. Although plan administrator decisions are normally reviewed on an abuse of discretion standard, the court instead applied a de novo standard. This was due to the fact that Microsoft's interpretation had not been presented to the plan administrator, and both parties had indicated that a remand to the administrator would "serve no useful purpose." *Id.* at 1193.

78. *Id.* at 1194 (citing Barnes v. Indep. Auto. Dealers of Cal., 64 F.3d 1389, 1393 (9th Cir. 1995)).

79. *Id.* at 1196.

80. *Vizcaino II*, 120 F.3d at 1010.

81. *Id.* at 1011.

independent contractors, but rather as a warning that identified the effects that would follow if the freelancers were deemed to be independent contractors. But since they were not, the consequences detailed in the warning did not apply.[82]

Additionally, the en banc opinion rejected the view that the plan provisions barring freelancer participation in the Microsoft benefit programs that were contained in the independent contractor agreements could "stand on their own footing as a waiver of benefits, regardless of the [w]orkers' true status as employees."[83] In so ruling, the opinion did not bar the use of an employment agreement to forgo benefit plan participation rights an employee otherwise might have, but rather suggested that the employment agreements drafted by Microsoft were not sufficient to achieve that end. This left freelancer participation in the SPP plan to be determined by whether the freelancers were covered by the plan's eligibility language. Rather than deciding the matter itself, however, as the Ninth Circuit panel had done, the en banc ruling remanded the question of SPP participation rights back to the plan administrator for an initial determination of freelancer eligibility.[84]

IV. THE ROLE OF EMPLOYMENT CONTRACTS

For employers who desire to restrict benefit program eligibility to a specific segment of the workforce while excluding others, an essential requirement is to identify the target group and specify the nature of the differential treatment intended. Whether we believe such differential treatment to be justified or not, it is nevertheless preferable that the affected members of the workforce be made aware of the employer's intent. At the very least, this insures that all prospective employees will know the consequences of accepting the employer's offer. If they find the arrangement unacceptable, they will at least have the option to seek alternative work. This can only be accomplished with a clear employment contract.

Some courts have relied heavily on independent contractor agreements to deny benefit program participation, as illustrated by the Tenth Circuit Court of Appeals' decision in *Capital Cities/ABC, Inc. v. Ratcliff*.[85] Prior to

82. *Id.* at 1011-12.

83. *Id.* at 1012. The court added that viewing the benefit statements in this light would raise questions concerning the adequacy of the freelancers' waiver of the right to benefits given the mistake in premise of their independent contractor status. *Id.*

84. *Id.* at 1014.

85. 141 F.3d 1405 (10th Cir. 1998).

being acquired by Capital Cities/ABC, the Kansas City Star was delivered to customer homes by independent carriers who bought the newspaper from the Star at wholesale rates for resale at retail prices. The newspaper deliverers were conceded to be independent contractors under this arrangement.[86] Upon acquiring the Kansas City Star, Capital Cities/ABC ended this arrangement and required all newspaper deliverers to execute "Agency Agreements" that acknowledged the carriers as self-employed independent contractors responsible for their own benefits.[87] However, an IRS audit resulted in a Technical Advice Memorandum to the company concluding that many of the carriers were in fact common-law employees. The affected individuals then requested company benefits.[88]

When the carriers' claim that they were eligible to participate in the company's benefit program was reviewed at the district court level, the agency agreements they had signed were found to be controlling. According to the district court, "[t]he Agency Agreements define[d] the relationship of the parties. The [c]arriers [were] not entitled to benefits because the promise of benefits was a unilateral offer which they expressly rejected under the terms of the Agency Agreements."[89] On appeal, the carriers sought to rely on the Supreme Court's opinion in *Nationwide Mutual Insurance Co. v. Darden*,[90] which held that the common law definition of an employee governs the determination of eligibility for ERISA benefits.[91] However, the appeals court did not read *Darden* as controlling in the face of the Agency Agreements executed by the parties. These were characterized as "bilateral contracts entered into at the commencement of the working relationship-that the Carriers were not entitled to benefits under the Star's ERISA plans."[92] Adding force to this conclusion, moreover, was the fact that the carriers previously had been independent contractors who were outside of the company's system of benefits, and thus the Agency Agreements did not change their status.[93] In the final analysis, the question of whether the carriers were common law employees or independent contractors was

86. *Id.* at 1407-08.

87. *Id.* at 1408.

88. *Id.* The court noted that the IRS determination was later retracted. *Id.* at 1408 n.2.

89. Capital Cities/ABC, Inc. v. Ratcliff, 953 F. Supp. 1228, 1235 (D. Kan. 1997), *aff'd*, 141 F.3d 1405 (10th Cir.), *cert. denied*, 525 U.S. 873 (1998).

90. 503 U.S. 318 (1992).

91. *Id.* at 323.

92. *Capital Cities/ABC, Inc.*, 141 F.3d at 1410.

93. *Id.*

irrelevant. The controlling question instead was whether the carriers "voluntarily agreed that they would receive no benefits under the Plans."[94]

The Tenth Circuit considered a somewhat more ambiguous employment contract in reviewing a claim for pension benefits in *Boren v. Southwestern Bell Telephone Co., Inc.*.[95] As in *Capital Cities*, the agreement in *Boren* included a specific statement that Boren was to be considered an independent contractor.[96] However, there was no additional language excluding Boren from participation in any company benefit plan.[97] Only after Southwestern Bell declined to renew Boren's contract did he reconsider his relationship and conclude that he was an employee and therefore entitled to participate in the pension plan.[98] The claim for pension benefits was based on the argument that Boren was an employee as defined by the pension plan document.[99] In the court's view, however, this was not sufficient. It concluded that a pension is a unilateral offer accepted by an employee through the performance of work under an employment agreement.[100] In his agreement, however, Boren accepted that he was not an employee.[101] According to the court, "the express terms of Mr. Boren's service contracts, in which he agreed that he was not considered an employee 'for any purpose,' prevent him from claiming that the work he performed for Southwestern Bell constituted an acceptance of the company's unilateral offer of pension benefits."[102] In essence, by signing the employment agreement Boren was foregoing any right to pension benefits he might otherwise have had under the terms of the pension plan.

The Tenth Circuit decisions in *Capital Cities* and *Boren* illustrate the court's view that employment contract terms control for purposes of determining benefit program eligibility. This approach is also reflected in

---

94. *Id.* The court deemed any argument that the carriers had been coerced into an involuntary waiver of their benefit program participation rights "irrelevant." *Id.*

95. 933 F.2d 891 (10th Cir. 1991).

96. *Id.* at 892.

97. *Id.* The designation of independent contractor appeared in all of Boren's one-year contracts with the company after 1968. *Id.* Prior to that time the contracts did not specify Boren's status. *Id.*

98. *Id.*

99. *Id.* at 894. Even though Boren was never enrolled in the pension plan, he claimed that he should have been enrolled and that contributions should have been made in his behalf. *Id.* at 893.

100. *Id.* at 894.

101. *Id.* at 892.

102. *Id.* at 894.

Hockett v. Sun Co., Inc.,[103] where the Tenth Circuit, in rejecting Hockett's claim that he was a common law employee, emphasized the fact that Hockett had executed an agreement identifying his status as being that of an independent contractor.[104] Factors indicating employee status were of less significance, especially since Hockett had made the deliberate decision to change the terms of his employment arrangement.[105] The same approach was also used in *Smith v. Torchmark Corp.*,[106] with the court emphasizing "that a mutual understanding existed between the respective parties that the various employment agreements defined the nature of the benefits that the employees would receive."[107] Finally, in *Roth v. American Hospital Supply Corp.*,[108] the Tenth Circuit took the analysis one step further. It relied heavily on the declaration of status contained in an agreement between two companies in determining the benefit program eligibility of an individual who was paid by one of the entities to perform work for the other.[109]

The strongest case for giving effect to the terms of an employment contract that deny benefit program participation rights arises where the specific language of the employment agreement clearly states that the service recipient assumes no benefit program obligations to the service provider. If the agreement properly identifies the relationship of all of the relevant parties and unambiguously states that no benefits will be provided in return for services rendered, the result is an arrangement in which no one has been mislead about benefit program participation rights nor has any false information concerning the service provider's status been conveyed. Therefore, since all parties have voluntarily entered into the agreement with full awareness of its terms, the law should give each side the benefit of its bargain and no more. However, the straightforwardness of the argument masks a serious problem that can arise in circumstances where the terms of

---

103. 109 F.3d 1515 (10th Cir. 1997).

104. *Id.* at 1526.

105. *Id.* at 1526-27. Hockett had previously retired before returning to work for the company. *Id.* at 1518-19.

106. 82 F. Supp. 2d 1006 (W.D. Mo. 1999).

107. *Id.* at 1010.

108. 965 F.2d 862 (10th Cir. 1992).

109. *Id.* at 864. In *Roth*, American Hospital Supply bought Precision Plastic Corporation from the American Argonomics Corporation. *Id.* Roth, the chief executive officer of Precision, remained on Argonomics's payroll and became a loaned employee to Hospital Supply after the acquisition. *Id.* His claim for benefits from Hospital Supply was based on the grounds that he was its common law employee. *Id.* at 866-67. The court pointed to Roth's desire to remain on Argonomics's payroll due to its higher salary and benefits in rejecting his claim for participation in the Hospital Supply program. *Id.* at 867.

the employment agreement conflict with the terms of the benefit program plan documents. Courts must then decide whether to give effect to the general statements contained in the plan documents or to the more specific language encompassed within the employment agreement.

The Tenth Circuit Court of Appeals has offered one analytical approach to the problem. It has taken the position that benefit program plan documents represent unilateral offers made by the employer to its workforce. If a qualified individual then executes an employment contract that gives up the right to participate in the plan, he or she is simply declining the offer.[110] In effect, the Tenth Circuit rule amounts to the creation of a legal principle that the terms of the employment contract trump the benefit program participation rights created by the plan documents. However, while the court may appear to simply be respecting the parties' freedom of contract, other concerns are present that the court did not properly value.

The most obvious problem encountered in the Tenth Circuit's approach is the individual's lack of awareness that he or she is even eligible for benefits. When faced with a contract that states that no benefits will be provided, it is logical for the service provider to conclude that none is available or that he or she is ineligible. A far different situation would be presented if the employment agreement stated that the signer knew he or she was eligible to participate in the company's benefit program but declined to do so. That would represent a knowing decision to reject the company's offer. However, absent awareness of eligibility, there is little reason to conclude that benefit program participation rights have been waived. A more accurate description of the Tenth Circuit approach is that the right to participate in a benefit plan is forfeited by a failure to assert eligibility, not because the company's offer has been rejected.[111]

Of course, it can be argued that an acknowledgment by the parties to the employment agreement that no benefits will be provided should be deemed controlling since the statement is clear on its face in defining the conditions of compensation. Equally significant, however, is the fact that an important

110. *See Capital Cities/ABC, Inc.*, 141 F.3d at 1405, 1410; Boren v. Southwestern Bell Tel. Co., 933 F.3d 891, 894 (10th Cir. 1991).

111. There are other areas of the law in which distinctions are made between waivers and forfeitures. For example, a suspect undergoing custodial police interrogation must affirmatively waive his self-incrimination rights. This requires the administration of a warning followed by a knowing and intelligent relinquishment of the right. Dickerson v. United States, 530 U.S. 428 (2000); Miranda v. Arizona, 384 U.S. 436 (1966). In contrast, however, self-incrimination rights must be affirmatively asserted before a grand jury, without the requirement of a warning and waiver, or they are lost through forfeiture. United States v. Mandujano, 425 U.S. 564 (1976).

term and condition of employment offered to the workforce in the company's benefit plan documents is withheld without ever being disclosed. In effect, if courts enforce employment agreements over benefit plan documents in such cases, they will be giving employers the benefit of inconsistent statements regarding benefit program eligibility. Employers will profit from employment contracts that deny benefits even though they are simultaneously gaining the advantages of benefit plan documents that state that they are available.[112]

At the same time, however, in the modern American workplace benefits have become far too important to allow them to be lost so easily. There is a significant public policy interest in encouraging workers to participate in such employment-based programs as health insurance and retirement saving. Their failure to do so is likely to mean that others, including government safety-net programs, ultimately will have to bear the cost. Thus, if the benefit plan documents describe conditions of participation that apply to the service provider, but this information is withheld and an employment agreement is executed in which benefit program participation is declined, the employment agreement should not trump the more general benefit program plan documents.[113]

An additional prerequisite for enforcement of an employment contract that forgoes benefit program participation is that the signer's decision must be voluntary. However, the reality is that this is unlikely to be an insurmountable obstacle. Voluntariness, in this context, is usually taken to mean surrounding circumstances that permit the signer to make a free and uncoerced decision. While claimants may argue that their execution of an employment agreement acknowledging the absence of any benefits was involuntary because the agreement was presented on a take or leave it basis,

---

112. A United States Chamber of Commerce press release on April 24, 2001 reported that the results of a 1999 survey revealed that benefits now represent more than one-third of company payroll costs. The Chamber's chief economist, Dr. Martin Regalia, added that "[E]mployers continue to make a major investment in employee benefits as an indispensable employee retention tool in today's tight labor market." Press Release, U.S. Chamber Finds Employee Benefits Add More Than A Third to Payroll Costs, *available at* http://www.uschamber.org/Press+Room/2001+Releases/April+2001/01-67.htm (last visited March 19, 2002).

113. This approach was relied upon in the Ninth Circuit panel decision in the Microsoft litigation. There, the ESPP plan covered the Microsoft freelancers while the independent contractor agreements excluded them. The court found the plan provisions controlling. Vizcaino I., 97 F.3d 1187, 1198 (9th Cir. 1996).

this does not in and of itself render the agreement unenforceable.[114] Employers are entitled to set terms and conditions of employment, including those which relate to compensation. Just as an employer's refusal to raise salary levels for an individual worker above those applicable to a category of positions would be permissible, so too must an employer be given the right to determine what non-salary forms of compensation will be paid.

In general, service providers have not litigated to secure benefit program participation rights where their employment agreements represent accurate and complete statements of the character of the parties' employment relationship, and where there is no conflicting language in the benefit plan document they can point to in support of their claim.[115] Instead, claimant challenges have generally involved situations in which the employment agreement inaccurately describes the employment relationship, and eligibility for benefit program participation would be available to the service provider had the employer not misclassified his or her status. In these cases, public policy strongly suggests that the courts should accord less weight to the employment agreement and instead give preference to the criteria for participation contained in the benefit program plan documents.

The problem is best illustrated in cases involving employment agreements that declare the signer to be an independent contractor responsible for his or her own benefits. Later it is determined that the signer was in fact a common law employee who otherwise would fit within the benefit program participation scheme. The dilemma faced by the courts is

---

114. Where an employer requires execution of an employment agreement as a condition of hiring, the setting is suggestive of an adhesion contract. In analogous settings, however, where employees have been required to waive the right to a judicial forum for the resolution of employment disputes in favor of arbitration, courts have enforced the arbitration agreement as long as the arrangements are not otherwise unconscionable. *See, e.g.*, Cole v. Burns Int'l Sec. Serv., 105 F.3d 1465 (D.C. Cir. 1997); Geiger v. Ryan's Family Steak Houses, Inc., 134 F. Supp. 2d 985 (S.D. Ind. 2001); Wright v. Circuit City Stores, Inc., 82 F. Supp. 2d 1279 (N.D. Ala. 2000); Armendariz v. Found. Health Psychcare Serv., (Cal. 2000). *But cf.* Mcoy v. Superior Court, 87 Cal. App. 354 (2001) (holding arbitration agreement procedurally unconscionable due to absence of meaningful choice arising from unequal bargaining power).

115. An exception exists under ERISA section 510, 29 U.S.C. § 1140 (1994), in circumstances involving the elimination of benefits previously provided. In *Inter-Modal Rail Employees Ass'n v. Atchison Topeka & Santa Fe Railway Co.*, 520 U.S. 510 (1997), the Supreme Court held that an employer that shifted employees to a subcontractor to perform the same work could be liable for taking action that interfered with ERISA benefit rights even though the employees were not mislabeled or given misleading information about benefit eligibility. ERISA's anti-interference prohibition does not apply to those who are not already employees.

whether they should enforce the employment agreement's statement acknowledging that no benefits would be provided when the document also includes a mischaracterization of employment status that, when corrected, would result in the individual's eligibility to participate in the benefit program.

The cases decided by the Tenth Circuit Court of Appeals reflect the view that an acknowledgment by the service provider that he or she will not receive any benefits should be taken seriously.[116] It is a clear statement of the relationship between the parties and constitutes adequate notice that any service provider who wishes benefits should take the necessary steps to secure them from some other source. As long as the parties were not otherwise disabled from entering into the arrangement, the terms and conditions to which they agreed should be enforced. Arguably, this analysis could also apply to cases in which the terms and conditions of employment are established in an agreement between the service recipient and an employment service in the business of providing labor,[117] as long as the actual workers have been made aware of the fact that they can expect no benefits from the service recipient.

The premise of the Tenth Circuit approach is that agreements voluntarily entered into should be enforced. This premise, however, is only superficially applicable to cases in which the acknowledgment of no benefits is coupled with an incorrect statement of employment status. This is a critical factor in the analysis, and provides support for the approach used by the Ninth Circuit Court of Appeals in *Vizcaino*.

When an employee enters into a contract stating that he or she is an independent contractor who is not entitled to participate in company benefit programs, the precise nature of the agreement is not clear. One possibility is that the individual is content with the arrangement, even though it is based on a misclassification, because he or she prefers the independent contractor status and is not particularly interested in receiving benefits. This may be because the individual is able to secure benefit plan coverage through a spouse or parent, or because the compensation level offered is higher than regular employees of the company receive, and the excess will allow the individual to pick precisely the benefits he or she desires. On the other hand, it is also possible that the employee believes the company's classification is correct and recognizes his or her benefit ineligibility as a direct consequence of that classification. In that case, even though the agreement may be

116. *See, e.g.*, Hockett v. Sun Co., Inc., 109 F.3d 1515 (10th Cir. 1997); Boren v. Southwestern Bell Tel. Co., 933 F.2d 891 (10th Cir. 1991).

117. *See* Roth v. Am. Hosp. Supply Corp., 965 F.2d 862 (10th Cir. 1992).

voluntary in the sense that there is no impermissible coercion facing either party, it is based on a mistake that would have altered the result had it been known. Simply calling it an agreement that must be enforced fails to give adequate weight to the significant public policy concern that access to health insurance, retirement planning and other important benefits must be readily available. Since these benefits have come to be closely tied to the workplace,[118] there is no justification for allowing eligibility to be so easily forfeited as a result of the employer's misclassification of his workforce.

Frequently, the original independent contractor classification is a reflection of the employer's effort to avoid the impact of laws that require employers to contribute to social security and unemployment compensation programs.[119] Employers may also seek to avoid such labor protective legislation as workers compensation,[120] the Family and Medical Leave Act,[121] the National Labor Relations Act[122] and ERISA.[123] If the employer

---

118. Significant tax and pricing advantages exist for benefits provided in connection with employment. Employers can secure health insurance, for example, at favorable group rates, and to the extent employees contribute to the cost they may do so with pre-tax income if the employer maintains a flexible spending account program. *See generally* RESEARCH INSTITUTE OF AMERICA, BENEFITS COORDINATOR §§ 33,901-33,926 (1998); Mark Edwards, *Replace Payroll Taxes with a Cafeteria Plan*, 82 ILL. B.J. 161 (1994); David Langer, *How a Flexible Spending Account Works*, *in* THE PRACTICAL ACCOUNTANT, Mar. 1989, at 77-78. Workplace-based retirement programs include tax-deferred retirement accounts as well as Roth IRAs in which contributions are taxable, but income earned on the contributions is tax-exempt. I.R.C. § 408 (1994 & Supp. 2000).

119. Employer contributions to the Social Security and Unemployment Compensation programs on behalf of *employees* are required by the Federal Insurance Contribution Act ("FICA"), I.R.C. §§ 3101-3128 (1994 & Supp. 2000), and the Federal Unemployment Tax Act ("FUTA"), I.R.C. §§ 3301-3311 (1994 & Supp. 2000).

120. Independent contractors are typically excluded from workers compensation coverage. *See, e.g.*, Home Design, Inc., v. Kansas Dep't of Human Res., 2 P.3d 789 (Kan. App. 2000); Fritts v. Williams, 992 S.W.2d 375 (Mo. App. S.D. 1999). *See generally* MARK A. ROTHSTEIN ET. AL., EMPLOYMENT LAW 548-50 (2d ed. 1999).

121. Family and Medical Leave Act, 29 U.S.C. §§ 2601-2654 (1994 & Supp. 2000). Coverage under the FMLA is limited to "eligible employee[s]." *Id.* § 2611(2).

122. The National Labor Relations Act specifically excludes coverage for independent contractors. 29 U.S.C. § 152(3) (1994).

123. In *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318 (1992), the Supreme Court held that coverage under ERISA was limited to those satisfying traditional agency standards for establishing a master-servant relationship. The Court observed: "In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished." *Id.* at 323 (quoting Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 751 (1989)).

is to obtain all of these benefits, there is every reason for the law to insist that the independent contractor label be properly applied. If instead the employer has misclassified his workforce, neither the government in enforcing labor protective legislation, nor the individual who has been adversely affected, should be barred from the benefits of the correct classification.

Even if the law were to adopt the position that an independent contractor agreement acknowledging that the service provider will receive no benefits is unenforceable if the service provider has been misclassified, one problem area still remains. Although employment agreements written in this form are unlikely, it is conceivable that the document could contain a statement that the job applicant will receive no benefits along with additional language asserting that this will be the result regardless of the service provider's correct classification.[124] It can be argued that in such a case the service provider cannot claim that he or she has been misled by an incorrect employment classification since the document would state that the absence of benefits applies regardless of the classification. Nevertheless, the arrangement can generate problems if, in fact, the correct classification would make the individual eligible for benefits that he or she has acknowledged are inapplicable under the terms of the contract.[125]

Even in this setting, however, there is a strong public policy argument supporting the conclusion that the terms of the benefit program should trump anything inconsistent in the employment agreement. The statement of eligibility criteria contained in benefit program documents represents a significant decision by the employer to offer a benefit plan to his workforce[126] and should be taken seriously when the coverage decision is

---

124. At the very least, an employment agreement written in this form would alert the service provider that his or her supposed independent contractor classification is in error. Employers would be understandably reluctant to waive so clear a red flag.

125. This type of situation is distinct from a waiver of the right to participate in a benefit program. A true waiver situation is one in which the job applicant has the right to choose to accept or reject the benefit without jeopardizing his or her employment. This differs from the situation in which declining the benefit is made a condition of employment.

126. An employer is not legally obligated to provide workplace benefits. Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73, 78 (1995) (stating that "ERISA does not create any substantive entitlement to employer-provided health benefits or any other kind of welfare benefits. Employers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans."). If such benefits are provided, however, ERISA bars employers from denying eligibility on the basis of age or length of service if the claimant is over twenty-one and has worked for the employer for more than one year. 29 U.S.C. § 1052(a) (1994 & Supp. 2000). States generally do not mandate employer

made and publicized. Broad statements of eligibility contained in the plan documents help to create the overall environment and structure of the workplace.[127] Pulling back such benefits through individual employment agreements allows the employer to gain the benefits of broad program eligibility criteria without actually having to apply them. Employers always have the option of restating benefit program eligibility criteria if they so desire.[128] However, this should be done directly through an amendment to the plan rather than by the largely secretive process of securing individual employment agreements forgoing benefit program participation.

V. BENEFIT PROGRAM EXCLUSIONS

As existing case law demonstrates, independent contractor agreements, whether applied to true independent contractor relationships or used as a tool to assist in worker misclassification, may not be fully effective in shielding the employer from the benefit claims of employees who have been wrongly excluded from benefit plan participation. While it is true that some courts emphasize the importance of employee agreements acknowledging independent contractor status and forgoing the right to participate in benefit plans,[129] other courts have been willing to go behind the contract to evaluate the employment relationship de novo.[130] However, even where this is the case, an employer may still rely upon exclusions contained in the benefit plan in support of the denial of benefit rights. But this merely shifts the focus of the inquiry to the question of the extent to which employers should be permitted to establish benefit plans which allow them to pick and choose those who will receive coverage.

---

benefit programs, although there are exceptions. *See, e.g.*, HAW. REV. STAT. § 393-21 (2000) (requiring mandatory pre-paid health insurance for eligible employees). Due to their expense, some employers have moved to eliminate benefit programs. Rodney Ho, *Fewer Small Businesses Are Offering Health Care and Retirement Benefits*, WALL ST. J., JUNE 24, 1998, at B2 (reporting the results of one survey revealing a decrease in small businesses offering such benefits from 46% to 39% between 1996 and 1998).

127. *See supra* note 29.

128. Changing a benefit plan merely requires that the plan documents contain amendment provisions that identify the procedure for amending the plan and those with the authority to amend the plan. 29 U.S.C. § 1102(b) (1994 & Supp. 2000). Simply stating that the company reserves the right to amend or modify the plan meets this requirement. *Schoonejongen*, 514 U.S. at 78-79.

129. *E.g.*, Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405 (10th Cir. 1998); Roth v. Am. Hosp. Supply Corp., 965 F.2d 862 (10th Cir. 1992); Boren v. Southwestern Bell Tel. Co., Inc., 933 F.2d 891 (10th Cir. 1991).

130. *E.g.*, Vizcaino I., 120 F.3d 1006 (9th Cir. 1997).

It is well established under existing law that employers have no duty to create benefit plans.[131] At the same time, however, employers are also free to reach the judgment that their internal human relations environment or external competitive considerations necessitate establishing such non-wage benefits as pension and 401(k) retirement plans, or health insurance programs. The choice of whether or not to establish such a system belongs entirely to the employer, and can be made free of the constraints of ERISA, applicable tax laws and regulations, and any other general labor statute. There were proposals during the early 1990s for mandatory employer sponsored health care insurance that received the support of the Clinton administration, but intense opposition to the plan surfaced and no legislation was enacted.[132] Since then, the idea of a system of mandated employer benefits has remained dormant.

Even though federal law may not mandate the establishment of employer-sponsored benefit programs, that does not necessarily mean that benefit programs created voluntarily by employers must also be free from legal oversight. Despite the fact that the law may not impose a duty to offer employee benefits, it is entirely appropriate to insist that programs employers voluntarily create meet appropriate standards since employees covered by the programs have a justifiable expectation that they will receive the promised benefits. At a minimum, this suggests the need for standards to assure fiscal responsibility,[133] but it also justifies the development of criteria to govern benefit program eligibility. In fact, provisions of both ERISA and the Internal Revenue Code address benefit program eligibility standards, and benefit program claimants who have not been barred by independent contractor agreements have sought to rely upon such statutory sources to support their claims for plan coverage.

Under existing principles, whether or not a benefit program is structured to provide coverage for employees as defined by ERISA and the Internal Revenue Code can be critical. This was illustrated in *In re Watson*,[134] where the appellant sought to have the proceeds of his "Profit Sharing Plan and

131. *See Schoonejongen*, 514 U.S. 73.

132. Mandatory health insurance coverage was proposed during President Clinton's first term, but substantial opposition arose and ultimately no action was taken. *See, e.g.*, Cathie Jo Martin, *Stuck in Neutral: Big Business and the Politics of National Health Care Reform*, 20 J. HEALTH POLITICS, POL'Y & L. 431 (1995); James A. Morone, *Nativism, Hollow Corporations, and Managed Competition: Why the Clinton Health Care Reform Failed*, 20 J. HEALTH POLITICS, POL'Y & L. 391 (1995).

133. ERISA incorporates such regulation in its requirement that covered pension plans meet minimum funding standards by avoiding funding deficiencies. 29 U.S.C. § 1082.

134. 161 F.3d 593 (9th Cir. 1998).

Trust Agreement" excluded from his bankruptcy estate.[135] The court found that the plan was qualified for favorable tax treatment,[136] but did not qualify for coverage under ERISA and thus was ineligible for exclusion from the bankrupt's estate under 11 U.S.C. § 541(c)(2).[137] The basis for the denial was the fact that the plan did not qualify as an "employee benefit plan" under ERISA. As defined by the Secretary of Labor, such plans may not be limited for the exclusive benefit of the firm's owners as was the case for the Watson plan.[138] In so concluding, the court upheld the validity of Department of Labor regulations which deny employee status to "[a]n individual and his or her spouse . . . with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual and his or her spouse."[139]

While benefit plans must cover employees in order to secure legal protection, they may not extend beyond the category of employees without jeopardizing the advantages of their tax-qualified status. Pension plans, for example, receive important tax advantages under applicable provisions of the Internal Revenue Code. Contributions made by employers to such plans are deductible in the year made,[140] the plan's earnings are not taxable during the period of accumulation[141] and the beneficiary is not taxed until benefits are actually received.[142] However, these tax benefits only apply to programs that are limited to the firm's employees.[143] This exclusive benefit rule[144] can present a problem for employers who utilize multiple classifications of service providers, not all of whom are employees, as well as for companies in the business of providing workers and work groups to their clients.[145]

---

135. *Id.* at 594.

136. *Id.* at 595.

137. *Id.* at 596 (citing Patterson v. Shumate, 504 U.S. 753 (1992) (finding that pursuant to the Bankruptcy Code and ERISA, an anti-alienation provision in qualified pension plan is an enforceable restriction on transfers from the plan).

138. *Watson,* 161 F.3d at 595.

139. *See id.* at 596 (citing 29 C.F.R. § 2510.3-3(c)(1) (1998); *see also* Kennedy v. Allied Mut. Ins. Co., 952 F.2d 262 (9th Cir. 1991) (denying ERISA qualification to pension plan covering only the owners of the company).

140. *See* I.R.C. § 404 (1994 & Supp. 2000).

141. *See* I.R.C. § 501 (1994 & Supp. 2000).

142. *See* I.R.C. § 402 (1994 & Supp. 2000).

143. *See* I.R.C. § 401 (1994 & Supp. 2000).

144. Qualified pension, profit sharing and stock bonus plans under the tax code are limited to those which are established for the "exclusive benefit of [the employer's] employees or their beneficiaries." I.R.C. § 401(a) (1994 & Supp. 2000).

145. Prof'l & Executive Leasing Inc. v. Commr., 862 F.2d 751 (9th Cir. 1988) (company engaged in the business of leasing professional staff denied tax qualified status for

Even if public policy might dictate extending benefit plan protection to certain classes of non-employees, existing legal principles are not broad enough to be applied in such a fashion.[146]

Where the benefit plan is properly constructed, courts will normally enforce exclusions as provided in the controlling plan documents.[147] However, employers may be tripped up as a result of plan language that does not clearly accomplish the inclusions and exclusions intended when the plan was created. Microsoft faced this problem in *Vizcaino* where plan language extended benefit rights to employees on the company's United States payroll. The panel decision of the Ninth Circuit concluded that this covered the freelancers who were paid by the accounts receivable department over the company's objection that only those paid through the payroll department were eligible.[148] Another illustration of this problem is provided by the Third Circuit decision in *Epright v. Environmental Resources Management, Inc.*[149] The plan at issue covered full-time employees defined as those who worked a minimum of thirty hours per week on a continuous basis.[150] The company, however, engaged in a practice of classifying new employees as either full-time, part-time, or temporary.[151] Those holding positions that were classified as temporary were subject to reclassification at the company president's discretion, but were denied plan coverage as long as their status remained in the temporary category.[152] Although the company maintained that it was following longstanding practice, and that the use of the classification of full-time employee in the plan was ambiguous, the court

---

its pension plans covering such leased workers since the workers in question were not subject to the control of the company and therefore were not its employees).

146. Barnhart v. N.Y. Life Ins. Co., 141 F.3d 1310, 1313-14 (9th Cir. 1998) (holding Washington Supreme Court decision in *Marquis v. City of Spokane*, 922 P.2d 43 (1996) (en banc), allowing independent contractors to bring discrimination suits under Washington state law, not controlling for purposes of determining rights under ERISA and the ADEA).

147. *See, e.g.*, Smith v. Torchmark Corp., 82 F. Supp. 2d 1006, 1010 (W.D. Mo. 1999) (enforcing the exclusion of agents where they were "expressly and unambiguously" not part of the definition of those covered by the plan).

148. Vizcaino I., 97 F.3d 1187, 1195-96 (9th Cir. 1996). The en banc majority opinion did not disagree with this conclusion, but rather determined that the case should be remanded to the plan administrator to rule on Microsoft's interpretation since it had not been presented to the administrator when the initial claim for benefits was made. Vizcaino II., 120 F.3d 1006, 1013-14 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998).

149. 81 F.3d 335 (3d Cir. 1996).

150. *Id.* at 338.

151. *Id.*

152. *Id.*

disagreed.[153] Therefore, because the plaintiff/temporary employee met the requirements for coverage established in the plan by virtue of his full time status, benefit program participation could not be denied.[154]

The case law clearly suggests that employers are well advised to exercise maximum care in drafting benefit program eligibility criteria in order to insure that management's intent is accurately reflected in the relevant plan documents. Yet, even the most careful drafting cannot eliminate all possible contingencies. Employers, however, can still rely on a legal environment that is receptive to employer objectives. One reflection of this environment is the right to amend the benefit plan by reserving amendment authority in the plan documents. ERISA requires that the plan documents identify the locus of authority to amend as well as the amendment procedure, but a simple designation of the company as the amending authority suffices for both purposes.[155] Moreover, as long as the plan vests discretion to determine benefit eligibility in the plan administrator, such decisions are reviewable only for abuse of discretion.[156] Therefore, companies can generally avoid undesired benefit participation results by either carefully drafting plan eligibility criteria, amending the plan when unexpected contingencies arise, or by relying on the discretion vested in the program administrator to interpret plan language.

Plaintiffs who have sought to participate in benefit plans, and who are not blocked by independent contractor agreements, either because they were not required to sign one or because they have been invalidated as not representing the actual employment relationship between the parties, must rely on the terms of the benefit plan to secure coverage. If, however, the terms of the benefit plan exclude categories of service providers, individuals in those categories face serious obstacles in their efforts to obtain participation rights.[157] In effect, they are asking for a court to order benefit plan coverage for an individual explicitly excluded by the terms of the

153. *Id.* at 340.

154. *Id.*; *see also* Cent. States, S.E. & S.W. Areas Pension Fund v. Kroger Co., 226 F.3d 903 (7th Cir. 2000) (holding part time workers covered by collectively bargained pension plan over company objection that they were excluded 'casual' employees).

155. Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73, 81-82 (1995).

156. Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 115 (1989).

157. *See, e.g.*, Wolf v. Coca-Cola Co., 200 F.3d 1337, 1340-42 (11th Cir. 2000) (denying benefit claim of staffing company worker assigned to defendant due to plan exclusion of temporary and seasonal employees); Abraham v. Exxon Corp., 85 F.3d 1126, 1132 (5th Cir. 1996) (enforcing plan exclusion of leased employees); Casey v. Atl. Richfield Co., 2000 WL 657397 (C.D. Cal. 2000) (upholding denial of benefits to leased worker excluded by terms of the benefit plan).

benefit plan itself. Relying on this, benefit plan drafters might conclude that they have virtually unrestricted freedom to select those who are eligible for benefit plan coverage. The better the drafting, the less likely it would be that the plan would ultimately have to cover unintended beneficiaries.

In an effort to avoid this outcome, it can be argued that governing legal principles should be interpreted to restrain the ability of an employer to restrict benefit program eligibility. The argument rests on the premise that if the benefit plan is precluded from excluding categories of workers from participation, they are fully entitled to claim benefits when their eligibility arises. The law would thus mandate benefit program inclusion even though the terms of the benefit plan itself would produce the opposite result.

An early example of the use of statutory principles to compel benefit program participation is provided by the decision of the Tenth Circuit Court of Appeals in *Crouch v. Mo-Kan Iron Workers Welfare Fund.*[158] There, the plaintiff, who had worked as a secretary for a local union, was denied welfare and pension benefits.[159] Both plans covered employees of the union who were not otherwise covered by a collective bargaining agreement, and the union itself was listed by the plan as an employer with respect to its own employees.[160] The plans further defined plan participants as "any employee ... of an employer."[161] However, over the course of the plaintiff's employment, the local union as employer made no contributions to the welfare or pension plan on her behalf because of its belief that she was not covered.[162]

In considering Crouch's claim for welfare benefits, the court noted that such benefits are not subject to the participation, vesting and funding requirements that govern pension plans.[163] As a result, according to the court, "the law permits a welfare plan to discriminate against particular employees."[164] This, coupled with what the court felt were ambiguities in the plan's governing documents, led to the conclusion that the managers did not abuse their discretion in denying welfare plan coverage.[165]

Although the court recognized that the pension plan had almost identical eligibility language as the welfare plan, it reached the opposite conclusion

158. 740 F.2d 805 (10th Cir. 1984).
159. *Id.* at 806-07.
160. *Id.* at 807.
161. *Id.*
162. *Id.* at 808.
163. *Id.*
164. *Id.*
165. *Id.*

with respect to the plaintiff's claim for pension benefits.[166] The court emphasized the fact that pension plans are subject to minimum participation, vesting, and funding requirements under ERISA.[167] The court also emphasized the fact that in order to qualify for favorable tax treatment, pension plans must satisfy the requirements of the Internal Revenue Code.[168] These requirements specifically include a ban against discrimination in favor of highly compensated employees, and a requirement of coverage for all employees over age twenty-five and having at least one year of service involving 1,000 or more hours of work.[169] The court's construction of the relevant Internal Revenue Code and ERISA provisions led it to conclude that Crouch was entitled to participate in the pension plan even though the local union had never contributed to the plan on her behalf.[170] The statutes thus overrode the plan managers' interpretation of the pension plan's scope of coverage. This was true despite the fact that comparable plan language covering the welfare benefit program led the court to conclude that the exclusion of Crouch from the welfare plan was not an abuse of discretion.[171]

The application of statutory standards in the determination of benefit plan coverage has been an issue with respect to leased employees. Employers have made increasing use of employee leasing agencies as a way of leveling business cycle disruptions.[172] Employers can maintain a core of

166. *Id.*

167. *Id.*

168. *Id.* at 808-09.

169. *Id.* at 809.

170. *Id.*

171. The court found extra support for its conclusion in a provision of the plan stating that is was to be construed in accordance with the requirements of ERISA. *Id.* at 800. The fact that comparable language appeared in both the welfare and pension plan documents, however, was not sufficient to produce identical results in both cases. *Id.*

172. Leased employees are part of the larger category of contingent workers characterized by the lack of an expectation of job continuity. According to the definition of the Bureau of Labor Statistics, "Contingent workers are persons who do not expect their jobs to last or who report that their jobs are temporary." Press Release, Bureau of Labor Statistics, U.S. Dept. of Labor, Contingent and Alternative Employment Arrangements, Feb. 2001, *at* http://stats.bls.gov/news.release/conemp.nr0.htm (last visited March 19, 2002). While employee leasing is sometimes used to describe all forms of arrangements to provide labor, its focus is the provision by the leasing company of various human relations services for the client firm. EDWARD A. LENZ, CO-EMPLOYMENT: EMPLOYER LIABILITY ISSUES IN THIRD-PARTY STAFFING ARRANGEMENTS 11 (1997). *See generally* H. Lane Dennard, Jr. & Herbert R. Northrup, *Leased Employment: Character, Numbers, and Labor Law Problems*, 28 GA. L. REV. 683 (1994).

permanent employees, and supplement the workforce with leased workers as need arises. The leasing agreement can be terminated when production needs no longer require additional workers.[173] However, if the leased workforce works side by side with permanent employees, performing the same tasks under the same supervision, they may well meet all the criteria for common law employee status. If so, the argument can be made that they are entitled to all benefit program participation rights afforded to permanent employees with whom they share common law employee status.

The use of statutory standards to provide benefit plan coverage is illustrated by the ruling in *Renda v. Adam Meldrum & Anderson Co.*[174] Renda was the employee of a company that leased space in the defendant's store to operate a jewelry sales and repair department.[175] During her period of employment, however, Renda was subject to the defendant's dress code and wore the defendant's nametag.[176] Dismissals and the power to control Renda's conduct were also handled by the defendant rather than the jewelry department.[177] Insurance and pension plans were established by the defendant, and the jewelry department lessee was given the option to participate.[178] While the jewelry department lessee accepted the insurance plan for his employees, he chose to decline to participate in the pension plan.[179] Therefore, when Renda retired she was denied any pension benefits.[180]

Renda illustrates the problems that arise in the case of leased employees who meet the test for common law employee status. Since Renda was found to be a common law employee,[181] the question then became whether existing law permitted the employer to exclude her. This, in turn, required reference to ERISA, which bars pension plans from requiring:

> as a condition of participation in the plan, that a employee complete a period of service with the employer or employers maintaining the plan extending beyond the latter of the following dates—

---

173. The use of contingent employees in this fashion is described in NOLLEN & AXEL *supra* note 23, at 38-39; *see also* Angela Clinton, *Flexible Labor: Restructuring the American Workforce,* 120 MONTHLY LABOR REV. 3 (Aug. 1997).

174. 806 F. Supp. 1071 (W.D.N.Y. 1992).

175. *Id.* at 1073-74.

176. *Id.* at 1074.

177. *Id.* at 1076.

178. *Id.* at 1075.

179. *Id.*

180. *Id.*

181. *Id.* at 1080.

(i) the date on which the employee attains the age of 21; or
(ii) the date on which he completes one year of service.[182]

According to the court, ERISA's language "effectively prohibits participation requirements which discriminate against certain employees such as leased employees."[183] The jewelry department's decision not to participate in the pension plan was thus irrelevant since the defendant and its plan did "not legally possess the discretion, as plan administrators and fiduciaries, to condition participant status on the decision of the department head alone."[184]

The *Renda* court's decision granting pension plan participation rights was founded on the participation standards contained in ERISA. The court recognized that it was conceivable that the plan might also have been discriminatory under applicable Internal Revenue Code regulations. However, it concluded that, "strictly speaking, . . . a discriminatory classification under section 410(b) would only show that this was not a qualified tax plan."[185] At the same time, however, the court viewed the tax regulations as "useful for extracting subtler shades of meaning necessary to paint a more detailed portrait of an individual's substantive rights under ERISA."[186] Thus, the Treasury Department regulations, according to the court, can serve to help guide the interpretation of ERISA participation requirements, even though they are not conclusive in determining participant rights.

The *Crouch* and *Renda* decisions were both influential in a Colorado federal district court ruling extending benefit program participation to leased employees. In *Bronk v. Mountain States Telephone & Telephone, Inc.*,[187] the plaintiffs were workers who provided services through "temporary service agencies or leasing agencies, and who [fell] within the common law definition of employee."[188] The relevant plan language in *Bronk* extended coverage to "regular employees," but employees from leasing and temporary employment agencies sought inclusion on the grounds that the limitation was inconsistent with ERISA.[189] The defendant, in contrast, relied on the

182. Id. at 1081 (quoting 29 U.S.C. § 1052(a)(1)(A) (1994 & Supp. 2000)).
183. *Id.*
184. *Id.* at 1083.
185. *Id.*
186. *Id.*
187. 943 F. Supp. 1317 (D. Colo. 1996).
188. *Id.* at 1319.
189. *Id.*

language of the plan and the discretionary authority conferred on plan administrators to interpret its reach. The district court, however, rejected the employer's argument, viewing the real question to be "not whether the administrator properly applied the terms of the plans; rather, it is whether, as a matter of law, the administrator was required to include [the] Plaintiffs within the coverage provisions of the Plans."[190] Relying on the Tenth Circuit's earlier decision in *Crouch*, particularly its conclusion that pension plans are subject to ERISA's minimum participation, vesting and funding requirements, the court concluded that leased workers who qualify as common law employees could not be excluded from plan participation rights.[191] To the contrary, all such employees must be included in the benefit plans if they meet ERISA's age and length of service requirements.[192] The court found further support for this conclusion in the relevant Treasury Department regulations, which it took as "persuasive authority in determining the rights of an employee to participation in an employee benefit plan."[193]

While there are decisions that use statutory principles to regulate benefit plan participation criteria, other rulings reach the opposite conclusion. These decisions view existing Internal Revenue Code provisions and Treasury Department regulations as establishing the criteria for favorable tax treatment of the benefit program, not as directives addressing the participation decision. Similarly, ERISA is viewed as allowing employers the freedom to determine benefit program eligibility as long as participation criteria are not based upon age or length of service.[194]

Perhaps the most prominent of the judicial decisions rejecting statutory grounds for determining benefit program eligibility is the Tenth Circuit Court of Appeals' reversal of the Colorado district court decision in *Bronk v. Mountain States Telephone & Telephone, Inc.*[195] In succinct language, the Tenth Circuit disagreed with the district court conclusion that minimum participation standards contained in ERISA required the inclusion in the employer's pension benefit plan of leased employees who met the test for

190. *Id.* at 1322.

191. *Id.* at 1322-23.

192. Program applicants less than twenty-one years of age or with less than one year of service may be excluded. 29 U.S.C. § 1052(a)(1)(A) (1994 & Supp. 2000).

193. *Bronk*, 943 F .Supp at 1324 (citing Renda v. Meldrum & Anderson Co., 806 F. Supp. 1071, 1082 (W.D.N.Y. 1992)).

194. This prohibition excludes the permissible criteria under ERISA that the benefit program applicant be at least 21 years of age and have worked for the company for at least one year. 29 U.S.C. § 1052(a)(1)(A) (1994 & Supp. 2000).

195. 140 F.3d 1335 (10th Cir. 1998).

common law employee status.[196] The only restriction the Tenth Circuit recognized was that pension plans could not discriminate based upon age or length of service, but the employer "need not include in its pension plans all employees who meet the test of common law employees."[197] Statutory support for this conclusion was found in ERISA language referring to employees "otherwise entitled to participate in the plan,"[198] language that "would be superfluous unless Congress intended that plans could impose other participation requirements besides age or length of service."[199] Moreover, in overruling the district court, the Tenth Circuit rejected the applicability of *Crouch*, viewing that decision as based upon plan language requiring compliance with ERISA and the Internal Revenue Code, rather than statutory standards dictating plan participation rights independent of the terms of the plan.[200]

In allowing the company pension plan to exclude leased employees, the *Bronk* court was able to rely on the Fifth Circuit Court of Appeals' decision in *Abraham v. Exxon Corp.*[201] There the court rejected a claim for benefit program participation by a leased employee who was specifically excluded under the terms of the plan.[202] The court concluded that ERISA does not bar program eligibility exclusions as long as they are not based upon age or length of service.[203] The court also rejected the argument that Treasury Department regulations requiring that leased employees be counted as employees in determining whether the plan met non-discrimination requirements mandated the inclusion of such leased workers in the plan. For the court, the regulations determined eligibility for beneficial tax treatment rather than serving as a device that barred the employer from excluding categories of workers from the plan.[204]

The Tenth Circuit Court of Appeals ruling in *Bronk* found additional support from the decision of the Fourth Circuit Court of Appeals in *Clark v. E.I. DuPont De Nemours & Co., Inc.*[205] There, neither the participation requirements of ERISA nor tax provisions requiring that leased employees be counted in determining whether the plan met non-discrimination

196. *Id.* at 1338.
197. *Id.*
198. 29 U.S.C. § 1052(a)(4) (1994 & Supp. 2000).
199. *Bronk*, 140 F.3d at 1338.
200. *Id.* at 1338-09.
201. 85 F.3d 1126 (5th Cir. 1996).
202. *Id.* at 1128.
203. *Id.* at 1130.
204. *Id.* at 1131.
205. No. 95-2845, 1997 WL 6958 (4th Cir. Jan. 9, 1997).

requirements were deemed sufficient authority to mandate leased employee inclusion in the company's benefit plan.[206] A similar result was reached by the Eleventh Circuit Court of Appeals in *Wolf v. Coca-Cola Co.*[207] The exclusion of leased employees by the plan was deemed permissible in light of the conclusion that neither ERISA nor the Internal Revenue Code mandate participation rights.[208]

Among the most recent cases, however, the Ninth Circuit Court of Appeals' decision in *Burrey v. Pacific Gas & Electric Co.*[209] raises questions about the exclusion of leased employees from employer benefit plans.[210] The pension and retirement plans at issue were made available to company employees, but not to leased workers as defined by the Internal Revenue Code.[211] Concluding that the plaintiffs were leased workers, the district court denied their claims,[212] but the Ninth Circuit Court of Appeals reversed. It noted that the plans specifically referred to the leased employee definition in Internal Revenue Code 414(n),[213] which it interpreted to cover those workers who were *not* common law employees of the recipient of the services, but nevertheless provided substantially full time services pursuant to an agreement for a period of at least one year.[214] The court reasoned that this structure required an initial determination of common law employee status, and that such a determination would bar categorization of the employee as an excluded leased employee.[215] Service providers could thus be classified as common law employees or leased workers, but not both. Subsequent cases, however, have distinguished *Burrey* on the basis of its inclusion in the governing documents of a reference to the statutory

---

206. *Id.* at *3-4.

207. 200 F.3d 1337 (11th Cir. 2000).

208. *See* Casey v. Atlantic Richfield Co., 2000 WL 657397 (C.D. Cal. 2000).

209. 159 F.3d 388 (9th Cir. 1998).

210. *Id.* The plaintiffs had been company employees, but were shifted to the payroll of an employment agency in 1983. *Id.* at 390. However, their employment environment did not change following the shift until 1994. *Id.* At that point they were not longer permitted to use company business cards and letterhead, participate in company training programs, receive company cars or be reimbursed for company-related expenses. *Id.* at 390-91.

211. *Id.* at 392.

212. *Id.* at 391.

213. *Id.* at 392.

214. *Id.* at 392-93.

215. *Id.* Under the court's interpretation, leased employees are those who meet the statutory criteria contained in I.R.C. § 414(n) (1994 & Supp. 2000) *but* do not satisfy the test for common law, employee status. *Id.* The categories are mutually exclusive. *Id.*

definition of leased employees contained in the Internal Revenue Code.[216] This leaves the question of whether workers obtained from employee leasing firms can be excluded from employer sponsored benefit programs even though they are also common law employees under applicable standards somewhat unclear.

VI. COURTS, LEGISLATURES, AND LEGAL OVERSIGHT STANDARDS

There can be little dispute that benefits have become an important component of an employee's overall compensation package. Health insurance, in particular, has been rated by workers as the most desired workplace benefit,[217] but pension and retirement plans are becoming increasingly important. This is due to the uncertainties surrounding the social security system[218] as well as the fact that with an increasing life expectancy, Americans will need retirement income for a longer period of time.[219] Yet, despite employee interest in such critical benefits as health insurance and retirement income, there are signs of problems in both areas.

---

216. Wolf v. Coca-Cola Co., 200 F.3d 1337, 1341-42 (11th Cir. 2000). Both cases viewed the *Burrey* court as having concluded that where a plan incorporates eligibility for all common law employees, leased employees who fit common law employee criteria may be covered. *Id.*

217. PAUL FRONSTIN, EMPLOYMENT-BASED HEALTH BENEFITS: TRENDS AND OUTLOOK 3 (Employee Benefit Research Institute Issue Brief, No. 233, May, 2001).

218. The impending retirement of the baby boom generation presents a challenge to the viability of the Social Security system. Although estimates keep changing, one view is that by 2029, Social Security payroll taxes will only be able to cover 77% of the benefits due. *See* Barry Rehfeld, *Fixing Social Security,* INSTITUTIONAL INVESTOR, Dec. 1996, at 82. Reform proposals have included allowing for the investment of some Social Security contributions in the equity markets. *See* Christopher Georges, *Overhaul of Social Security is Endorsed by Panel,* WALL ST. J., May 18, 1998, at A3. The draft report of the Social Security Commission appointed by President George W. Bush stated that by the year 2020, a two-earner family would face $860 in increased taxes to cover the anticipated shortfall or an annual reduction in benefits of $2,227. *See* John D. McKinnon, *Bush Commission Begins to Make Case that Social Security Must Be Overhauled,* WALL ST. J., July 20, 2001, at A12. Covering the shortfall by spending cuts would require the equivalent of eliminating of the Departments of Education, Interior and Commerce, the Environmental Protection Agency, and a number of antipoverty programs. *See* PRESIDENT'S COMM'N TO STRENGHTEN SOCIAL SECURITY 5-6 (Staff Draft, rev. July 23, 2001), *available at* http://csss.gov/reports/7-23_Draft_Interim_Report.pdf (last visited March 19, 2002).

219. In the year 2000, a male aged 65 had a life expectancy of 20.5 years. The comparable figure in 1983 was 17.8 years, and in 1989 it was 19.3 years. *See* John M. Bragg, *New Mortality Table Shows Up on Annuity Block,* NAT'L UNDERWRITER LIFE & HEALTH-FIN. SERVS. EDITION, Jan. 20, 1997, at 8.

Health care coverage has been a high profile public policy issue at the national level because of concerns about the large number of Americans who lack any form of health insurance. In 1999, it was reported that 42.1 million Americans had no health care insurance coverage,[220] although that was the first year since 1987 when the actual percentage of Americans covered grew.[221] Nevertheless, the number of uninsured remains high, and the twin pressures of rising health benefit costs and a slowing economy may lead to a future slippage in coverage rates.[222] There is reason to believe that these pressures may cause more employers to move to defined contribution benefit systems in which employers limit the total amount of money they contribute to employee benefit programs, and employees then select the benefit mix they prefer.[223] The impact of this on employee health care utilization will then depend upon the precise health insurance packages employees choose.

Significant changes are also underway within the American employer-based pension system. Most dramatic among these changes is the shift from defined benefit to defined contribution retirement plans.[224] However, the available evidence indicates that this will increase the risk that employees will use retirement funds for non-retirement purposes, a phenomenon known as "retirement leakage."[225] There is also reason for concern that not enough Americans are saving for retirement at a sufficient rate to insure that they will be able to meet their eventual retirement needs.[226]

The pressures being placed on the health insurance and pension systems in the United States are serious enough even for members of the traditional full-time and permanent workforce. However, these problems are exacerbated by employer efforts to restrict benefit program eligibility

---

220. Fronstin, *supra* note 217, at 8.

221. The percentage of uncovered Americans declined from 18.4% in 1998 to 17.5% in 1999. *Id.* at 8.

222. *Id.* at 15-18.

223. *Id.* at 20.

224. A report prepared for the United States Department of Labor observed that the trend away from defined benefit plans is "well underway and shows little or no evidence of abating." REPORT OF THE WORKING GROUP ON THE MERITS OF DEFINED CONTRIBUTION VS. DEFINED BENEFIT PLANS WITH AN EMPHASIS ON SMALL BUSINESS CONCERNS 7 (Dep't. of Labor, Nov. 13, 1997).

225. U.S. DEP'T OF LABOR ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFITS, REPORT OF THE WORKING GROUP ON RETIREMENT PLAN LEAKAGE: "ARE WE CASHING OUT OUR FUTURE?" 4 (Nov. 13, 1998).

226. Jonathan Clements, *Getting Going: 'I Plan to Save Like Crazy Someday'*, WALL ST. J., June 26, 2001, at C1; Glenn Ruffenach, *Fewer Americans Save for Their Retirement*, WALL ST. J., May 10, 2001, at A2.

through such devices as the use of employment agreements that explicitly deny benefit program participation rights, as well as by benefit program eligibility criteria that are drafted to exclude contingent workers from coverage. While statistics identifying how often employment agreements are used to bar benefit program participation are not available, researchers have given increasing attention to the use of contingent workers by American employers as benefit program avoidance devices. Considering the category to include part-time workers as well as those who lack permanency, the group is variously estimated as between 25% and 31% of the American workforce.[227] Given that one of the major reasons for utilizing contingent workers is to reduce total employee costs, it is not surprising to find that contingent workers are far less likely to have health and pension benefits through their employers when compared to regular full-time workers.[228]

Independent contractor agreements have been relied upon by many employers as a means of avoiding the variety of consequences that follow the establishment of an employment relationship. One such obligation is the duty to include otherwise eligible employees in benefit programs made available to the employer's regular workforce. In response to this duty, employers have come to see the advantages of creating a two-tier workforce,

227. REPORT OF THE WORKING GROUP ON RETIREMENT PLAN LEAKAGE, *supra* note 206, at 6 (Table 1) (noting the Bureau of Labor Statistics estimate that contingent employees represent 25.3% of the American workforce; the Economic Policy Institute estimate that they represent 28.6% of the American workforce and the W.E. Upjohn Institute estimate that they represent 31.2% of the American workforce).

228. The Employee Benefit Research Institute reported that 66.5% of regular full-time workers have health benefits through their employers, while the figure for temporary help agency personnel is 8.5%; contract company workers 57.9%; regular part-time workers 15.7%; and on-call workers 33.2%. The Institute further reported that the percent of workers with pension benefits through their employers is 56.8% for regular full-time workers as compared to 16.2% for regular part time workers; 39.9% for contract company workers; 28.4% for on-call workers; and 4.6% for temporary help agency personnel. *See* ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFIT PLANS, U.S. DEP'T OF LABOR, REPORT OF THE WORKING GROUP ON THE BENEFIT IMPLICATIONS OF THE GROWTH OF THE CONTINGENT WORKFORCE 6-7 (Tables 2 and 3), *available at* http://www.dol.gov/dol/pwba/public/adcoun/contrpt.htm (last visited March 19, 2002). The Bureau of Labor Statistics reported that in February, 1999, 74.2% of all workers over the age of 16 were eligible for employer-provided health insurance, while only 33.9% of contingent workers had such eligibility. Steven Hipple, *Contingent Work in Late-1990s*, MONTHLY LABOR REVIEW, March, 2001, at 18, Table 11, *available at* http://stats.bls.gov/opub/mrl/2001/03/art1abs.htm (last visited March 19, 2002). The same study found that 59.0% of all workers over the age of sixteen were eligible for employer-provided pensions, while the comparable figure for contingent workers was 23.0%. *Id.* at 21, Table 13.

with only a limited number of service providers qualifying as employees eligible for benefit program participation rights.

If an employer successfully creates an independent contractor or other contingent employment relationship with service providers, the fact that an employment agreement has been executed adds nothing to the benefit program consequences of the arrangement. The benefit program exclusion contained in the agreement is superfluous if the underlying benefit plan documents limit eligibility to properly categorized common law employees. Benefit programs that an employer provides to his employees need not be provided to non-employees, whether or not an agreement to that effect has been executed between the parties.

Courts, however, have been confronted with cases in which employers rely on employment agreements to deny benefit program participation rights even where the service provider meets the standard for common law employee status. Despite this inconsistency, a number of courts have concluded that acknowledgments of benefit program ineligibility contained in such agreements are binding even though the agreements misstate the true nature of the relationship between the parties.

While it is certainly true that workers have a right to decline to participate in health insurance and retirement programs, using an employment agreement to achieve that objective is a method that does not deserve legal support. Where an employee has been hired for a position, presented with benefit program options, and then chooses not to participate, that decision should be enforceable as a voluntary choice made by an individual aware of the available alternatives. However, the reality faced by many workers is that they are presented with employment agreements that deny benefit program eligibility on a take it or leave it basis.[229] The individual signatory is not given the option to participate in or decline the benefit program, but rather is told that his services will not be employed unless he agrees to forgo any benefit program rights. To make matters worse, this is coupled with misinformation concerning the service provider's status under the law. Given these circumstances, enforcing the individual's acknowledgment that he or she will not be eligible for company benefits provides the employer with an unfair advantage. Instead, such employment agreements should be disregarded and benefit program eligibility enforced as long as the service provider comes within the benefit program's eligibility criteria.

---

229. This, of course, was the essence of the Microsoft freelancer contracts that the Ninth Circuit ultimately concluded was not controlling. *See* Vizcaino II., 120 F.3d 1006 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998).

Even if an employer properly structures an employment relationship that avoids common law employee status, serious questions remain about the wisdom of allowing such an arrangement to circumvent eligibility for benefits the employer has chosen to make available to his regular workforce. This does not mean that traditional independent contractor arrangements should trigger benefit program eligibility. If the employer hires a plumber to fix leaky pipes, or construction workers to add an addition to the plant, or an accountant to audit the books, compensation is appropriately limited to payment for the services rendered. However, these are traditional discrete business arrangements, usually with firms that have other clients and are perfectly able to create their own benefit programs.

In recent years, however, contingent employment relationships had been used in a much different manner. Rather than reflecting the use of service providers for discrete tasks, contemporary contingent employment arrangements frequently offer no distinction between the contingent workers and the employer's regular permanent staff. Both groups typically perform the same tasks in the same manner, with little if anything to distinguish them. Contingent employees of this variety have a need for benefit plan coverage comparable to traditional common law employees. Yet, employers often arbitrarily segment their workforce into separate groups to secure the limitation of worker access to company benefit programs.[230]

The need to address the benefit program problems encountered by contingent employees has not gone unrecognized by Congress. Legislative awareness has grown that worker mislabeling through employment agreements has been used by employers as a way of disqualifying contingent workers from the right to participate in benefit programs. Similarly, notice has been taken of the use of contingent employment relationships as a way of avoiding coverage of workers under employer benefit programs limited to "employees." Both issues have been the subject of legislation submitted to Congress.

The problem of the mislabeling of workers to avoid benefit program participation rights, reflected in both employment agreements and other devices, was addressed in the Employee Benefits Eligibility Fairness Act of

---

230. *E.g.*, Hensley v. N.W. Permanente, 1999 WL 685886 (D. Or. 1999) (excluding common law employees under *Darden* standard from ERISA plan by plan administrator because they were not issued IRS W-2 forms); Bielkie v. Gen. Motors Corp., No. 98-1873, 1999 U.S. App. LEXIS 20318 (6th Cir. Aug. 19, 1999) (per diem employee excluded from retirement plan despite the fact that her work history was inconsistent with handbook per diem definition).

2000.[231] Sponsored by Senator Edward Kennedy, the bill's findings note that the goal of protecting pension and welfare benefits that underlies ERISA "is frustrated by the practice of mislabeling employees to improperly exclude them from employee benefit plans,"[232] and that "[e]mployment contracts and reports to government agencies also are used to give the erroneous impression that mislabeled employees work for staffing, temporary, employee leasing, or other similar firms, when the facts of the work arrangement do not meet the common law standard for determining the employment relationship."[233] To solve the problem, the legislation proposed invalidating any exclusion from benefit program participation rights if premised on the individual's miscategorization.[234] As written, the proposed legislation is broad enough to prohibit benefit program exclusions even where the individual was notified in advance that his non-employee categorization *might* be erroneous.

The Ninth Circuit Court of Appeals achieved the same result as the proposed Employee Benefits Eligibility Fairness Act by recognizing that an employment contract that mislabels a worker is at best a mistake.[235] It should therefore be read as a prediction of the benefit program consequences that would apply if the signatory was in fact an independent contractor, not as a binding agreement withdrawing benefit program eligibility regardless of the service provider's true status.[236] Unfortunately however, some legislative action may be necessary to correct the decisions of other courts that inappropriately emphasize the inaccurate terms of the employment contract over the reality of the employment relationship.[237]

The proposed Employee Benefits Eligibility Fairness Act also contained provisions governing benefit program eligibility for common law employees

---

231. Employees Benefit Eligibility Fairness Act of 2000, S. 2946, 106th Cong. (1999).

232. S. 2946 § 2(a)(1).

233. S. 2946 § 2(a)(2). The bill also identified the problem of mislabeling employees as contractors, and paying them from sources other than normal payroll accounts, "to give the appearance that they are not employees of their worksite employer." *Id.*

234. The relevant language states that:

> [A]ny waiver or purported waiver by an employee of participation in any pension plan or welfare plan shall be ineffective if related, in whole or in part, to the miscategorization of the employee in 1 or more ineligible plan categories.

S. 2946.

235. Vizcaino II., 120 F.3d 1006, 1012 (9th Cir. 1997), *cert. denied,* 522 U.S. 1098 (1998).

236. *Id.* at 1011.

237. *E.g.*, Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405 (10th Cir. 1998); Smith v. Torchmark Corp., 82 F. Supp. 2d 1006 (W.D. Mo. 1999).

paid through third party labor suppliers or pursuant to employer arrangements other than the firm's normal payroll procedures. Under the terms of the bill, work performed by common law employees, regardless of the specific arrangements for their compensation, would be counted as service in determining whether the duration of the worker's employment was sufficient to establish benefit eligibility.[238] Additionally, according to other provisions of the bill, pension plans would be deemed to violate ERISA if common law employees who performed the same work as regular employees were excluded from plan participation rights.[239] The bill was thus designed to ensure that employers would not be able to set up or utilize sham labor suppliers as a way of avoiding benefit program obligations by treating their covered common law employees as excluded leased labor.

Legislative efforts to protect benefit program eligibility for contingent workers are also reflected in the proposed Contingent Workforce Equity Act introduced in the Senate in 1994.[240] As part of a broad based effort to provide labor law protection to contingent workers, the proposed legislation sought to reduce the hours of service required for retirement and health care benefits to extend coverage to more part time workers.[241] Protection for contingent worker benefit eligibility was also contained in the proposed ERISA Clarification Act of 1999.[242] The legislation would have required that all service by common law employees be considered in determining benefit program eligibility, whether or not the worker was paid through a third party agency.[243] The legislation also provided that benefit program exclusions "must be made on a uniform basis, must be stated in the plan, must be based on reasonable job classifications, and must be based on

238. Employee Benefits Eligibility Fairness Act of 2000, S. 2946 106th Cong. § 3(9) (2000).

239. S. 2946 § 3(b).

240. Contingent Workforce Equity Act, S. 2504, 103d Cong. (1994).

241. *Id.* § 202. The legislation also proposed special rules for health and retirement benefit coverage for temporary workers in the federal service. *Id.* §§ 401-403. The treatment of part-time workers has also been addressed by the European Union in its Framework Agreement on Part-Time Work (1997) in which member governments were called upon to adopt the principle that part-time workers should not be treated less favorably than full-time workers and that the principle of *pro rata temporis* should apply where appropriate. *Council Directive 97/81/EC of 15 December, 1997, concerning the Framework Agreement on Part-time Work Concluded by UNICE, CEEP and the ETUC.* Annex, 1998 O.J. (L 014) 9, clauses 4(1) & 4(2), *available at* http://europa.eu.int/eur-lex/en/lif/dat/1997/en_397L0081.html (last visited March 19, 2002).

242. ERISA Clarification Act of 1999, H.R. 2299 106th Cong. (1999).

243. H.R. 2299 § 2.

objective criteria."[244] This provision would grant courts the authority to review benefit plan eligibility standards based upon the stated legislative criteria, as opposed the existing deferential review standard that effectively leaves program participation rights in the hands of those with the conflicting responsibility of having to pay the benefit claims.

VII. CONCLUSION

Unquestionably, there has been a steady increase in the utilization of contingent workers by American employers, with more and more firms creating two-tier employment structures. The result is a growing class of workers excluded from access to important benefit programs. It is unlikely that the high utilization rate for contingent workers will be reversed as long as employers conclude that the system generates production efficiencies. This does not mean, however, that the impact of this drift on worker eligibility for critical benefit programs should be ignored. To the contrary, workers should not be left on the sidelines simply because employers have found contingent employment relationships to be an easy tool for benefit program avoidance.

Some courts have indicated that they are prepared to resist the trend, but this has not uniformly been the case. As a result, consistency in the treatment of contingent workers will not be achieved unless legislative solutions are found. At a minimum, what is required is a clear legal statement that employment agreements which mislabel workers as non-employees cannot be used as a device to deny benefit program eligibility. Enforcement of a worker's decision to refuse to participate in a benefit program should require that the individual be accurately classified and be given the option to accept or reject the program in the same fashion as properly labeled common law employees.

It is also necessary to address the problem of benefit program drafting that creates arbitrary benefit program exclusions, which leave contingent workers uncovered. There is an obvious need to be certain that exclusion criteria are clearly stated and do not make artificial distinctions between those extended coverage and those excluded. While there is justification to separate out true independent contractors and supplied labor who have access to benefits from other sources, arbitrary categorizations that lack any real underlying distinctions between worker groups should not be permitted. Artificial benefit program eligibility standards should not remain a device

244. *Id.*

employers are free to use in order to frustrate a worker's right to participate in otherwise available workplace benefit programs.