

ARTICLES

THE CONTINGENT EMPLOYEE BENEFITS PROBLEM

MARK BERGER*

Americans have increasingly come to understand the central role that work plays in adult life. Part of that role is a reflection of the self-identity and social associations generated by the workplace. Individuals often define themselves by the kind of work they perform, and frequently form their closest friendships with workplace colleagues.¹ Perhaps more central, however, is the economic role of work. Simply put, most individuals look at work as a means of securing the resources required to purchase the necessities and luxuries of life.²

Obviously, the more a worker earns through employment, the better position he or she is in to succeed in the marketplace as a consumer. Higher salaries are likely to mean better housing, a better car, more entertainment and greater economic security. But at the turn of the century, the economic aspects of work have come to mean more than simply the search for a higher salary to allow for

* Professor of Law, University of Missouri—Kansas City School of Law. B.A., 1966, Columbia; J.D., 1969, Yale Law School. The author wishes to acknowledge the valuable research assistance provided by Maggie Neustadt and Nicole Yarbrough, third year law students at the University of Missouri—Kansas City School of Law. Preparation of this Article was supported by a grant from the University of Missouri—Kansas City School of Law Research Fund.

1. See Glenn Burkins, *A Special News Report About Life On the Job and Trends Taking Shape There*, WALL. ST. J., Nov. 4, 1997, at A1 (reporting that employees say they are generally happier and more productive when they have friendships in the workplace); Jolie Solomon, *Workplace: Love at the Workplace, But No Labor's Lost*, WALL. ST. J., Aug. 22, 1990, at B1 (reporting on a study revealing that strong bonds and relationships in the workplace help employees perform their jobs and enliven the atmosphere for their co-workers; most of the respondents surveyed indicated that these relationships made them more creative, productive and happy).

2. An indication of the critical importance of earnings from work to the economic well-being of Americans is the increasing number of families who depend upon multiple wage earners. The Bureau of Labor Statistics reported that in 1996 more than half of all families had a husband and wife both working, a figure which was nearly three times that of "traditional" families in which only the husband worked. BUREAU OF LABOR STATISTICS, U. S. DEP'T OF LABOR, EMPLOYMENT CHARACTERISTICS OF FAMILIES SUMMARY 1 (May 21, 1998) (visited Nov. 1, 1998) <<http://stats.bls.gov/news.release/famee.t02.htm>> [hereinafter BUREAU OF LABOR STATISTICS I]. See also *More Families Have Two Incomes, BLS Says*, 158 Lab. Rel. Rep. (BNA) 147 (June 1, 1998). In 1947, just over one third of American families had two wage earners compared to 57% in 1994. These two-wage families averaged an income 80% higher than single-worker families. See *Where Both Spouses Work*, U.S. NEWS & WORLD REP., Aug. 19, 1996, at 13.

more and better quality purchases. The workplace has also become the focal point for securing a number of critical and often expensive employment-related benefits. These benefits include such essentials as health insurance and pensions, and in some employment settings, the chance to participate in the employer's financial success through employee stock purchase plans.

While workplace benefits such as pensions, health insurance and stock purchase plans might not have been common or considered critical to employees in the early part of the Twentieth Century, this is no longer the case in contemporary American society. Americans are now living longer, and it has therefore become increasingly important for them to secure a source of income after the conclusion of their work careers.³ At the same time, medical costs have grown so rapidly that the lack of health insurance can mean the inability to secure needed medical assistance.⁴ Stock purchase plans, although less widespread, have nevertheless become a source of wealth creation for many employees,⁵ and

3. A male aged 65 will have a life expectancy of 20.5 years in the year 2000, compared to 17.8 years in 1983 and 19.3 years in 1989. See John M. Bragg, *New Mortality Table Shows Up on Annuity Block*, NAT'L UNDERWRITER LIFE AND HEALTH-FIN. SERVS. ED., Jan. 20, 1997, at 8. Social Security has been a major source of post-retirement income, but the upcoming retirement of the baby-boom generation will require significant changes in the system if it is to survive. Younger workers frequently express doubt that the system will be available for them when their turn to retire arrives. Unless the Social Security program is changed, by 2029 it will have a deficit of nearly \$200 billion a year (in 1996 dollars), with payroll taxes able to cover only 77% of benefits. See Barry Rehfeld, *Fixing Social Security*, INSTITUTIONAL INVESTOR, Dec. 1996, at 82. Reform proposals include permitting individuals to invest some of their Social Security contributions in the equity market. See Christopher Georges, *Overhaul of Social Security is Endorsed by Panel*, WALL ST. J., May 18, 1998, at A3; *Clinton Plan for '99 Social Security Reforms Debated*, 157 Lab. Rel. Rep. (BNA) 466 (Apr. 20, 1998).

4. Over 40 million Americans currently have no health insurance coverage and are therefore deterred from seeking needed medical assistance. See Michael Cherhew et al., *The Demand for Health Insurance Coverage by Low-Income Workers: Can Reduced Premiums Achieve Full Coverage?*, HEALTH SERVICES RES., Oct. 1, 1997, at 453. Even the movement to managed care has not stopped the upward spiral in health care costs, although it may have slowed the rate of increase. See Jeffrey A. Tannenbaum, *Health Costs at Small, Midsize Firms Finally Fell Last Year, Survey Shows*, WALL ST. J., Sept. 11, 1997, at B2 (reporting health care costs at small and mid-size firms rising 6.2% in 1993, 3.4% in 1994, 1.6% in 1995, and dropping 1.6% in 1996); Joseph B. White & Rhonda L. Rundle, *Big Companies Fight Health-Plan Rates*, WALL ST. J., May 19, 1998, at A2. Many workers have been dropping employer-sponsored health insurance because of the increase in required employee contributions to total insurance costs. See Laurie McGinley, *More Workers Drop Health Insurance From Employers*, WALL ST. J., Nov. 10, 1997, at B2.

5. For example, Wal-Mart's stock purchase plan has provided significant financial rewards to many of its employees. See Sam Walton & John Huey, *The Secret of Wal-Mart's Success*, MONEY, July 1, 1992, at 24 (reporting that Wal-Mart's stock plan was available to every associate who had been with Wal-Mart at least one year and who worked at least 1000 hours a year). See also Elizabeth Seay, *Scrambling for Security: How Four Americans Spend and Save*, WALL ST. J., Dec. 12, 1997, at R5.

a significant feature in such industry sectors such as software and computers.⁶ However, despite the increasing importance of programs connected with health, retirement, and economic security, they are still largely associated with traditional employment relationships and often represent a significant cost to those employers which provide them.⁷

In response to the expansion in the scope and cost of workplace benefit programs, many employers have attempted to develop human resource systems which eliminate the need to offer fringe benefit plans, or at least restrict the group of eligible workers entitled to participate in them. To achieve this result, some employers simply discontinue providing employment-related benefits because offering them is generally not required by law.⁸ However, this is not always possible because eliminating benefit programs may make it difficult to attract and retain critical employees. As an alternative, employers have increasingly begun to utilize contingent employment relationships in which workers are hired directly for limited assignments or are retained through outside staffing agencies instead of being made a part of the employer's permanent work

6. *E.g.*, Microsoft stock rose 80% during 1997, resulting in employee stock options that averaged \$1 million. See Allan Sloan, *Millionaires Next Door: That Is, If Your Neighbors Work for Microsoft*, NEWSWEEK, Dec. 8, 1997, at 56. This employee incentive accounts for the largest outstanding financial obligation of Microsoft. See Michelle Elarier, *To Have and To Have Not*, CFO, Mar. 1998, at 58-61. See generally Allan Sloan et al., *The New Rich*, NEWSWEEK, Aug. 4, 1997, at 48.

7. See Joseph B. Mosca, *The Restructuring of Jobs for the Year 2000*, PUBLIC PERSONNEL MGMT., Mar. 1, 1997, at 43 (reporting that as health care costs increase, benefit packages are costing companies from 25% to 32% of total personnel compensation, and that benefit costs have risen at annual rate of 6.2%, a figure in excess of the rate of inflation). See also Fred R. Bleakley, *HMO Talks Could Spell Biggest Cost Rise in 4 Years*, WALL ST. J., July 18, 1997, at A9A; Christina Duff, *Compensation Costs Climb for Employers*, WALL ST. J., July 31, 1998, at A2; Louis Hau, *Rate Increases to Help HMOs' Boost Earnings as Enrollment Growth Slows*, WALL ST. J., July 20, 1998, at B5H. It has been argued that the system of employer-provided benefits distorts the employer-employee relationship and should be replaced by non-profit, private sector buying cooperatives. See Craig J. Cantoni, *Manager's Journal: The Case Against Employee Benefits*, WALL ST. J., Aug. 18, 1997, at A14.

8. See Federal Insurance Contribution Act ("FICA"), I.R.C. §§ 3101-3128 (1994 & Supp. II 1996), amended by I.R.C. § 3121 (West Supp. 1998). Employers are required to contribute to the Social Security and Unemployment Insurance programs for their employees, Federal Unemployment Tax Act ("FUTA"), 26 U.S.C.A. §§ 3301-3311 (1994 & Supp. II 1996), amended by I.R.C. §§ 3301, 3304, 3306, 3309 (West Supp. 1998), but the federal government does not mandate any additional pension or health care benefit programs for employees. Nor are such programs generally required by the states, although there are exceptions. See, e.g., HAW. REV. STAT. § 21-393 (1985) (requiring mandatory pre-paid health insurance for eligible employees). A recent survey revealed that small employers may be eliminating health care and retirement benefits despite a tight labor market; while 46% of the small business surveyed offered such programs in 1996, that number had dropped to 39% in 1998. Rodney Ho, *Fewer Small Businesses Are Offering Health Care and Retirement Benefits*, WALL ST. J., June 24, 1998, at B2.

force.⁹ Typically, employers continue to provide the normal array of workplace benefits to those in traditional employment positions, but deny equivalent treatment to those in contingent employment relationships.¹⁰ The result is a two-

9. There is no uniformly accepted definition of contingent employment other than a consensus that it is a relationship which differs from the pattern of full-time work for an indefinite period. It normally is considered to include such forms as part-time and short-term hirings, as well as leased employment and independent contractor arrangements. See STANLEY NOLLEN & HELEN AXEL, *MANAGING CONTINGENT WORKERS* 9 (1996); Mark Berger, *Unjust Dismissal and the Contingent Worker: Restructuring Doctrine for the Restructured Employee*, 16 *YALE L. & POL'Y REV.* 1, 9-18 (1997). The Bureau of Labor Statistics defines contingent employment as "almost any work arrangement that might be considered to differ from the commonly perceived norm of a full-time wage and salary job." BUREAU OF LABOR STATISTICS, U. S. DEP'T OF LABOR, *CONTINGENT AND ALTERNATIVE EMPLOYMENT ARRANGEMENTS*, REP. 900, at 1 (Aug. 17, 1995) [hereinafter BUREAU OF LABOR STATISTICS II]. According to recent studies, the number of temporary workers has increased more than fivefold since 1982, rising from 417,000 in 1982 to 2.3 million in 1996. See Mary Jane Fisher, *Closing the Benefits Gap for Temps and Contingent Workers*, NAT'L UNDERWRITER LIFE AND HEALTH-FIN. SERVICES EDITION, Apr. 14, 1997, at 54. According to a National Association of Temporary and Staffing Services survey, the daily employment of temporary help increased 10.7% in the first quarter of 1998. 158 *Lab. Rel. Rep. (BNA)* 382 (July 20, 1998).

10. One study noted that "a much smaller share of workers in nonstandard jobs have either health insurance or a pension compared to regular full-time workers." ECONOMIC POL'Y INST., *NONSTANDARD WORK, SUBSTANDARD JOBS: FLEXIBLE WORK ARRANGEMENTS IN THE U.S.* 29 (1997). A report on federal temporary help practices revealed that federal temporary workers are ineligible for participation in the federal employee retirement system and are not provided with Government-sponsored life insurance. They may participate in the health insurance program after one year of service, but without the 70% contribution to premium costs the Government makes for its permanent work force. U.S. MERIT SYSTEMS PROTECTION BOARD, *TEMPORARY FEDERAL EMPLOYMENT: IN SEARCH OF FLEXIBILITY AND FAIRNESS, A REPORT CONCERNING SIGNIFICANT ACTIONS OF THE U.S. OFFICE OF PERSONNEL MANAGEMENT* 12 (1994). See also, BENNETT HARRISON & BARRY BLUESTONE, *THE GREAT U-TURN: CORPORATE RESTRUCTURING AND THE POLARIZING OF AMERICA* 46 (1988); Steven Hipple & Jay Steward, *Earnings and Benefits of Contingent and Noncontingent Workers*, *MONTHLY LAB. REV.*, Oct. 1, 1996, at 22-30; "Contingent" Work Force Expands Rapidly as Firms Seek Buffers in Economic Downturns, 1985 *Daily Lab. Rep. (BNA)* No. 138, at A3 (July 18, 1985); *Contingent Workers Unfairly Deprived of Benefits, Job Security, Senate Panel Told*, 1993 *Daily Lab. Rep. (BNA)* No. 114, at d11 (June 16, 1993) (reporting on job restructuring undertaken by the Bank of America, which resulted in the conversion of 58% of its staff to hourly or temporary positions without the opportunity to receive benefits); *GAO Finds Greater Use of Contingent Workers, Warns of Strain on Income Protection System*, 1991 *Daily Lab. Rep. (BNA)* No. 59, at A1 (Mar. 27, 1991) (reporting concerns of Representative Tom Lantos that the rise of contingent employment practices creates the risk of shifting the costs of income protection and benefits from employers to workers and taxpayers). Responding to proposals to expand the definition of independent contractors for federal tax purposes, Secretary of the Treasury Robert Rubin expressed concern that such changes "could lead to widespread shifting of employees to independent contractor status, resulting in loss of worker

tier employment structure, with those in the lower tier usually excluded from all benefit program eligibility.

For some workers the loss of benefit eligibility may not be an insurmountable problem. This is true, for example, for those covered under the benefit program of a spouse or parent. Others who secure insurance through professional organizations such as the American Bar Association are in the same position. For the remainder, however, the inability to obtain coverage under an employer's benefit plan may well mean the inability to secure any benefits at all. When the benefits involved are as central as health insurance and a pension, serious economic hardship could result for those affected. Yet, this is exactly what has been happening to contingent workers.

The de-linking of benefit program participation from the employment relationship through the use of contingent employment arrangements was illustrated in recent litigation involving the Microsoft Corporation ("Microsoft").¹¹ A decision by a panel of the Ninth Circuit Court of Appeals held that certain contract workers for Microsoft were entitled to participate in the company's § 401(k) deferred compensation program as well its employee stock purchase plan even though they had signed an employment agreement recognizing that they were ineligible.¹² Subsequently, the core features of the decision were affirmed by the Ninth Circuit Court of Appeals in an en banc ruling, although questions concerning the interpretation of the deferred compensation plan document were remanded to the plan administrator for further consideration.¹³ Given the widespread practice of not providing benefits to

protections such as pension and health coverage." James Kuhnenn, *Going for Home-Based Businesses? Bills Could Mean Lower Federal Taxes, But Provision on Independent Contractors Could Put Some in a Bind*, KANSAS CITY STAR, June 28, 1997, at B1.

11. *Vizcaino v. Microsoft Corp.*, 97 F.3d 1187 (9th Cir. 1996) [hereinafter Microsoft Corp. I], *aff'd on reh'g*, 120 F.3d 1006 (9th Cir. 1997) (en banc) [hereinafter Microsoft Corp. II], *cert. denied*, 118 S. Ct. 899 (1998). A separate law suit has also been filed against Microsoft challenging the company's practice of denying temporary workers various health and pay benefits, as well as eligibility for stock options. The attorney for the plaintiffs indicated that class action status will be sought. *See Ten Microsoft Temps File Law Suit Alleging Unequal Treatment*, WALL ST. J., Nov. 20, 1998, at A6.

12. *Microsoft Corp. I*, 97 F.3d at 1187.

13. *Microsoft Corp. II*, 120 F.3d 1006 (9th Cir. 1997) (en banc), *cert. denied*, 118 S. Ct. 899 (1998). Prior to the start of litigation, Microsoft altered its employment structure in an effort to avoid any possibility of having to pay benefits to its contingent work force in the future. It did this by terminating what it had hoped was an independent contractor employment system and replacing it with the use of personnel provided by an employment leasing agency. *Id.* at 1009. The District Court, on remand, found that the plaintiff class includes former Microsoft contract workers secured through employment leasing agencies who nevertheless met the standards for classification as common law employees of Microsoft. *Vizcaino v. Microsoft Corp.*, No. C393-1780, 1998 WL 122084 (W.D. Wash. Feb. 13, 1998). Whether or not they are entitled to participation in all of the Microsoft benefit plans at issue, however, remains to be decided. *See* 1998 Daily Lab. Rep. (BNA) No. 138, at E11 (July 20, 1998); Lee Gomes, *America 1998: High on Stock Options: At Microsoft*,

members of the non-regular work force,¹⁴ the decision in the *Microsoft* case understandably raised concern among business interests.¹⁵

While an employer may be able to avoid some of the costs associated with employee benefits by supplementing core employees with contingent workers, it is also possible to take the further step of converting an existing work force into a contingent employee system. The result is that workers who had been covered by the employer's benefit plans will find themselves instantly excluded following the conversion. Where such plans are covered by the Employment Retirement Income Security Act ("ERISA"),¹⁶ however, the conversion may suggest that the employer is interfering with his workers' access to benefits in violation of the statutory prohibition contained in section 510 of ERISA.¹⁷ The Supreme Court addressed such a challenge in *Inter-Modal Rail Employees Ass'n v. Atchison, Topeka & Sante Fe Railway Co.*,¹⁸ but its ruling left the scope of ERISA's protection of benefit eligibility unclear. Nevertheless, the decision in *Inter-Modal*, in much the same fashion as the *Microsoft* ruling, demonstrates that there is an urgent need to address the benefit questions raised by the contingent employment phenomenon.

This Article, therefore, focuses on the problem of workplace benefits and

a War Smolders Between Haves and Have-Nots, WALL ST. J., Aug. 10, 1998, at B1.

14. See *supra* note 10.

15. See James P. Baker, *As a Result of the 9th Circuit's En Banc Ruling in the 'Microsoft' Case, Contingent Workers Who Had Agreed to Give Up Benefits Should Receive Them Retroactively*, 20 NAT'L L.J. 5, Sept. 29, 1997, at B5 (noting that the *Microsoft* cases seem to set a "dangerous precedent for employers" because they allow independent contractors who had agreed to forego employment benefits in exchange for more pay to receive the benefits retroactively); Susan L. Coskey, *Vizcaino v. Microsoft Corporation; A Labor and Employment Lawyer's Perspective*, 48 LAB. L.J. 91, 91-97 (1997); see also Michael A. Lawson et al., *Temp Workers May Be Eligible for Plan Benefits*, 19 NAT'L L.J. 26, Feb 24, 1997, at C2; Charles McCoy & David Bank, *Microsoft Loses Appeal in Worker-Benefits Case*, WALL ST. J., July 25, 1997, at A3. More recently, the Department of Labor demonstrated the government's concern that businesses may be misusing the contingent employee system to deprive workers of benefits by filing a suit against Time Warner seeking independent court review of the company's personnel policies. See Jacob M. Schlesinger & Eben Shapiro, *U.S. Challenges Time Warner on Benefits*, WALL ST. J., Oct. 27, 1998, at B20.

16. Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001-1461 (1994 & Supp. II 1996), amended by Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788-1103 (Aug. 5, 1997).

17. Pub. L. No. 93-406, title I, § 510, 88 Stat. 895 (codified at 29 U.S.C. §1140 (1994)). This section of ERISA makes it unlawful for any person to discharge, fine, suspend, expel, discipline or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan . . . or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan.

Id.

18. 117 S. Ct. 1513 (1997).

their relationship to contingent employment work arrangements. Initially, this Article explores the nature of contingent employment relationships and the various kinds of workplace benefits employees have come to rely upon. Following that is an analysis of the Ninth Circuit Court of Appeals rulings in the *Microsoft* case allowing contract workers to participate in company benefit plans, and the Supreme Court decision in *Inter-Modal* applying ERISA to the conversion of an employer's permanent work force into a leased staff. The Article then considers how courts in general have responded to efforts by contingent employees to secure various workplace benefits. Finally, proposed legislative and non-governmental solutions to the benefit problems of contingent employees are analyzed.

I. EMPLOYMENT RELATIONSHIPS AND THE BENEFIT MIX

Until recently, Americans have shared a common perception that employment meant a continuous job of indefinite duration. The offer of a job and its acceptance by the applicant was understood to imply that there would be no abrupt or arbitrary termination even if the parties never discussed a time frame for the position.¹⁹ Of course, this was never true for all workers in all situations. A college student, for example, might seek full-time employment for only the summer vacation period, or an office worker with clerical skills might accept a limited term assignment through a temporary help agency. But these exceptions did not alter the fact that typically employment was assumed to be continuous and without a fixed end.

Nevertheless, even jobs with indefinite terms of employment have not been understood as lifetime positions. For example, workers can expect to lose their jobs permanently if the employer goes out of business, or temporarily if there is a sudden downturn in production.²⁰ Similarly, it is accepted that employees may be let go because of poor work performance or some specific act of misconduct.²¹

19. See WILLIAM B. GOULD IV, *AGENDA FOR REFORM: THE FUTURE OF EMPLOYMENT RELATIONSHIPS AND THE LAW* 30 (1993); PAUL OSTERMAN, *EMPLOYMENT FUTURES: REORGANIZATION, DISLOCATION AND PUBLIC POLICY* 66 (1988); PAUL C. WEILER, *GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW* 144-45 (1990).

20. The impact of permanent job loss can be mitigated if the employer provides severance payments to terminated workers. The Supreme Court has held that state severance laws which mandate such payments are not preempted by ERISA. *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 3, 4 (1987). Additionally, for employers large enough to qualify, there may be an obligation to provide advance notice of large scale layoffs, whether permanent or temporary, pursuant to the federal Worker Adjustment and Retraining Notification Act ("WARN"). 29 U.S.C. §§ 2101-2109 (1994 & Supp. II 1996).

21. As Professor Paul Weiler has observed, workers may well expect to avoid termination unless the misconduct was sufficiently severe and then only after alternative punishments have proven ineffective:

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

But beyond circumstances of this sort, there has been a shared expectation among both employers and employees that the job-holder would have uninterrupted employment unless there was some reason to terminate the relationship.

That these expectations have existed is somewhat ironic given the fact that the law until recently has offered very little protection to individuals who have been discharged. In formal terms most employment has been classified legally as at-will, a status which allows the employer to discharge the employee for good reason, bad reason, or no reason at all.²² Treatise writer H. G. Wood described the concept in the Nineteenth Century, writing:

With us the rule is inflexible, that a general or indefinite hiring is *prima facie* a hiring at will, and if the servant seeks to make it out a yearly hiring, the burden is upon him to establish it by proof. A hiring at so much a day, week, month or year, no time being specified, is an indefinite hiring, and no presumption attaches that it was for a day even, but only at the rate fixed for whatever time the party may serve.²³

Subsequently, this principle was affirmed in decisions of the U.S. Supreme Court.²⁴ Nevertheless, the fact that the employer has always had the power to discharge without cause has not altered the general worker expectation of employment continuity.

In more recent years, however, the expectation of job continuity has begun to receive some measure of support from the legal system. One aspect of this is reflected in the numerous anti-discrimination laws which protect employees from discharge based upon specific prohibited reasons such as race and sex under Title

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.

WEILER, *supra* note 19, at 52 (1990).

22. See, e.g., *Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286 (N.D. Ill. 1983); *Hutton v. Watters*, 179 S.W. 134 (Tenn. 1915); *Payne v. Western & Atl. R.R. Co.*, 81 Tenn. 507 (1884). See generally Jay M. Feinman, *The Development of the Employment At Will Rule*, 20 AM. J. LEGAL HIST. 118 (1976).

23. H. G. WOOD, A TREATISE ON THE LAW OF MASTER AND SERVANT § 134 (William S. Hein & Co. 1981) (1877) (citations omitted). However, commentators have maintained that the cases upon which Wood relied did not support his statement of the rule. See Feinman, *supra* note 22; Matthew W. Finkin, *The Bureaucratization of Work: Employer Policies and Contract Law*, 1986 WIS. L. REV. 733, 734-35; Clyde W. Summers, *The Contract of Employment and The Rights of Individual Employees: Fair Representation and Employment At Will*, 52 FORDHAM L. REV. 1082, 1083 & n.7 (1984) (stating that “cases cited by Wood did not support his proposition”); Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335, 341 n.54 (1974).

24. *Coppage v. Kansas*, 236 U.S. 1 (1915); *Adair v. United States*, 208 U.S. 161 (1908).

VII of the Civil Rights Act of 1964,²⁵ age under the Age Discrimination in Employment Act,²⁶ and disabilities under the Americans With Disabilities Act.²⁷ Further strengthening expectations of job continuity has been the virtual revolution in state common law which has substantially modified the at-will rule. As a result of court decisions in the 1970s and 1980s most states now permit an employee to challenge a termination that was based upon reasons that violate state public policy.²⁸ Additionally, many state courts have developed common law principles that allow them to imply contract-based rights to employment premised upon specific actions taken by the employer,²⁹ or that establish a general contract right requiring that the employer adhere to the standard of good faith and fair dealing.³⁰ All of these developments, at both the state and federal level, recognize that the at-will employment rule, which precluded court

25. 42 U.S.C. §§ 2000e to 2000e-17 (1994 & Supp. II 1996).

26. 29 U.S.C. §§ 621-634 (1994 & Supp. II 1996).

27. 42 U.S.C. §§ 12101-12213 (1994 & Supp. II 1996).

28. The origins of the public policy exception to the at-will employment rule are generally traced to *Petermann v. International Brotherhood of Teamsters*, 344 P. 2d 25 (Cal. Ct. App. 1959), in which the court upheld a wrongful discharge claim following the termination of an employee who refused instructions to commit perjury before a grand jury. More recently, many courts have expanded the public policy theory beyond refusals to commit a crime, and have included terminations stemming from the employee's reporting of a crime, performance of public duty, and exercise of public rights. See *Pro v. Donatucci*, 81 F.3d 1283 (3d Cir. 1996); *Kelsay v. Motorola, Inc.*, 384 N.E.2d 353 (Ill. 1978); *Frampton v. Central Ind. Gas Co.*, 297 N.E.2d 425 (Ind. 1973); *Palmer v. Brown*, 752 P.2d 685, 687-88 (Kan. 1988); *Sventko v. Kroger Co.*, 245 N.W.2d 151 (Mich. Ct. App. 1976); *Phipps v. Clark Oil & Refinery Corp.*, 408 N.W.2d 569, 571 (Minn. 1987) (performing a public duty); *Boyle v. Vista Eyewear Inc.*, 700 S.W.2d 859 (Mo. Ct. App. 1985); *Potter v. Village Bank of N.J.*, 543 A.2d 80, 86 (N.J. Super. Ct. App. Div. 1988); *Nees v. Hocks*, 536 P.2d 512 (Or. 1975) (en banc); *Reuther v. Fowler & Williams, Inc.*, 386 A.2d 119 (Pa. Super. Ct. 1978); *Ludwick v. This Minute of Carolina, Inc.*, 337 S.E.2d 213 (S.C. 1985). One court has gone so far as to extend public policy protection to an armored car driver who left his vehicle to assist an individual who was being chased by a man with a knife. See *Gardner v. Loomis Armored Inc.*, 913 P.2d 377 (Wash. 1996) (en banc).

29. See *Wagner v. City of Globe*, 722 P.2d 250 (Ariz. 1986) (en banc); *Pugh v. See's Candies, Inc.*, 171 Cal. Rptr. 917 (Cal. Ct. App. 1981); *Cleary v. American Airlines, Inc.*, 168 Cal. Rptr. 722 (Cal. Ct. App. 1980); *Watson v. Idaho Falls Consol. Hosp., Inc.*, 720 P.2d 632 (Idaho 1986); *Toussaint v. Blue Cross & Blue Shield of Mich.*, 292 N.W.2d 880 (Mich. 1980); *Woolley v. Hoffmann-La Roche, Inc.*, 491 A.2d 1257 (N.J. 1985), *modified*, 499 A.2d 515 (N.J. 1985); *Weiner v. McGraw-Hill, Inc.*, 443 N.E.2d 441 (N.Y. Ct. App. 1982); *Benoit v. Ethan Allen, Inc.*, 514 A.2d 716 (Vt. 1986); *Thompson v. St. Regis Paper Co.*, 685 P.2d 1081 (Wash. 1984) (en banc).

30. See *Foley v. Interactive Data Corp.*, 765 P.2d 373 (Cal. 1988); *Merrill v. Crothall-Am., Inc.*, 606 A.2d 96 (Del. 1992); *Fortune v. National Cash Register Co.*, 364 N.E.2d 1251 (Mass. 1977); *Monge v. Beebe Rubber Co.*, 316 A.2d 549 (N.H. 1974). However, other courts have rejected this theory. See *Johnson v. McDonnell Douglas Corp.*, 745 S.W.2d 661 (Mo. 1988); *Murphy v. American Home Prods., Inc.*, 448 N.E.2d 86 (N.Y. Ct. App. 1983).

supervision of the decision to terminate an employee, must in certain circumstances give way to other interests. In so doing, the courts have increased the stability of traditional employment relationships³¹ by extending legal supervision to cover discharge decisions that offend selected public interests.

However, the generally accepted view that whether or not protected by law, employment relationships should be stable and continuous has come under intense pressure.³² In an increasingly competitive global business environment, employers have sought to limit what they see as the costs associated with traditional employment relationships. By avoiding commitments for indefinite employment, employers believe they can maintain flexibility to respond to varying business conditions.³³ If there is a temporary upturn in work requirements, the need can be met through the hiring of a temporary pool of workers. If production needs subsequently decrease, the workers can then be easily released. An employer might still face the necessity of retaining a core of traditional permanent employees to maintain essential continuity in production, but the costs of expanding and contracting the work force beyond that level are likely to be minimal.³⁴ As a result of this approach, the American labor market

31. While it may be true that workers are moving between jobs at a significant rate, this may obscure the degree to which workplace stability still survives. One researcher reported that although average job tenure for white males was just under four years, this figure hid the fact that the average tenure for white males for jobs *currently held* was 18 years. OSTERMAN, *supra* note 19, at 45. This reflects a pattern of experimenting with different jobs during the early stages of an individual's work life, followed by eventually settling in to a long-term job. Evidence exists, however, which suggests decreasing job stability in the United States. See Kenneth A. Swinnerton & Howard Wial, *Is Job Stability Declining in the U.S. Economy?*, 48 INDUS. & LAB. REL. REV. 293 (1995).

32. Americans have become accustomed to corporate layoffs even by financially healthy employers. See, e.g., Stephen E. Frank, *American Express Plans Lay-offs of 3,300*, WALL ST. J., Jan. 28, 1997, at A2 (lay-offs planned despite "solid" fourth-quarter earnings and a return on equity of 22.8%); Matt Murray, *Thanks, Goodbye: Amid Record Profits, Companies Continue to Lay Off Employees*, WALL ST. J., May 4, 1995, at A1 (citing lay-offs by Procter & Gamble Co., American Home Products Corp., Sara Lee Corp. and Banc One Corp.). An expanding economy may have slowed the rate of job loss in the mid-1990s, but worker displacement has continued. See Steven Hipple, *Worker Displacement in an Expanding Economy*, MONTHLY LAB. REV., Dec. 1, 1997, at 26, 26-39. Moreover, many of those terminated during the early 1990s recession have found recovery difficult due to apprehensions about the future. See Tony Horwitz, *Home Alone 2: Some Who Lost Jobs in Early '90s Recession Find a Hard Road Back*, WALL ST. J., June 26, 1998, at A1.

33. See EDWARD A. LENZ, CO-EMPLOYMENT: EMPLOYER LIABILITY ISSUES IN THIRD-PARTY STAFFING ARRANGEMENTS 10 (1997); Robert J. Grossman, *Short-Term Workers Raise Long-Term Issues*, HR MAG., Apr. 1, 1998, at 80, 81-82; Gregory L. Hammond, *Flexible Staffing Trends and Legal Issues in the Emerging Workplace*, 10 LAB. LAW. 161, 167-70 (1994).

34. This pattern has been called the core-periphery model, about which one researcher observed:

By establishing a labor force that is smaller than that actually required for normal production levels, the firm is able to offer that labor force relative security. In return,

has experienced dramatic growth in the utilization of non-traditional contingent labor to the point that contingent employees now represent the fastest growing segment of the domestic work force.³⁵

Although there is no generally accepted definition of contingent employment, the widespread awareness of the growth of non-traditional work patterns has led the Bureau of Labor Statistics (the "Bureau") to undertake surveys of non-continuous employment relationships in the United States. The Bureau defined the category of contingent employment as including "those individuals who did not [perceive themselves as having] an implicit or explicit contract for ongoing employment."³⁶ The definition was framed broadly enough to include "almost any work arrangement that might be considered to differ from the commonly perceived norm of a full-time wage and salary job."³⁷ The Bureau's survey of contingent employment in 1995, broadly construed, revealed a category totaling approximately six million persons, or 2.4-4.9% of the American work force.³⁸ Other estimates, however, have placed contingent employment at a higher level, suggesting that it may constitute as much as 30% of the domestic working population, with a rate of increase 75% higher than that of the overall work

these employees are willing to work under the salaried model and to provide both flexibility and commitment to the firm. The peripheral labor force provides the firm with a buffer against either macroeconomic—cyclical—downturns or labor force reductions necessitated by technical change.

OSTERMAN, *supra* note 19 at 85.

35. See Richard S. Belous, *The Rise of the Contingent Work Force: The Key Challenges and Opportunities*, 52 WASH. & LEE L. REV. 863, 867-68 (1995) (estimating that contingent employees represent between 25% and 30% of the American work force and have been growing at a rate 40% to 75% faster than the overall work force). A study published by the Economic Policy Institute came up with a comparable figure, concluding that "29.4% of all jobs were in nonstandard work arrangements . . ." ARNE L. KALLEBERG ET AL., NONSTANDARD WORK, SUBSTANDARD JOBS: FLEXIBLE WORK ARRANGEMENTS IN THE U.S. 1 (Economic Pol'y Inst. 1997). See also Charles S. Clark, *Contingent Work Force*, CQ RESEARCHER, Oct. 24, 1997, at 939 (reporting that the number of temporary workers grew 500% from 1980-96); Angela Clinton, *Flexible Labor: Restructuring the American Work Force*, MONTHLY LAB. REV., Aug. 1, 1997, at 3, tbl. 2 (reporting the growth of the business services industry at an annual rate of 6.9% since 1972, and 5.8% since 1988); *Employment: Global Companies Hiring More Temps; Trend Expected to Grow, Survey Finds*, 1995 Daily Lab. Rep. (BNA) No. 180, at d21 (Sept. 18, 1995).

36. BUREAU OF LABOR STATISTICS II, *supra* note 9, at 2. Elsewhere it has been suggested that the category should include individuals who "have little or no attachment to the company at which they work." NOLLEN & AXEL, *supra* note 9, at 5.

37. BUREAU OF LABOR STATISTICS II, *supra* note 9, at 1.

38. *Id.* A second survey released in December 1997, reported that the percentage of contingent workers had declined to between 1.9% and 4.4% of the American work force. BUREAU OF LABOR STATISTICS, U. S. DEP'T OF LABOR, CONTINGENT AND ALTERNATIVE EMPLOYMENT ARRANGEMENTS 1 (Feb. 1997) (visited Nov. 1, 1998) <<http://stats.bls.gov/news.release/conemp.nws.htm>> [hereinafter BUREAU OF LABOR STATISTICS III].

force.³⁹ Nevertheless, that there is no consensus concerning the extent of contingent employment relationships in the American economy does not alter the fact that it has become an increasingly significant employment pattern in recent years.⁴⁰

There are a mix of work relationships included within the contingent employment category. One variant is the temporary job which an individual may take for a limited period of time. Manpower, Inc., reportedly the largest private employer in the United States, has provided workers for this kind of assignment for approximately fifty years.⁴¹ The typical pattern is that the temporary help agency will either find skilled personnel or recruit and train the needed workers, thereafter referring them to employers who have listed available temporary positions.⁴² This has become an increasingly significant form of employment, now extending well beyond clerical jobs to include professional positions such as attorneys,⁴³ journalists,⁴⁴ and even physicists.⁴⁵

If an employer needs the services of a work force or of individual workers for a more extended period of time, other contingent employment arrangements may be required. One pattern is to employ the services of an employee leasing firm to perform the function of providing the work force and managing all related payroll and human resource services.⁴⁶ It is possible in this type of arrangement for the supplied workers to either be supervised by the contracting firm or to be part of a self-contained and supervised crew provided by the leasing company.

39. See Belous, *supra* note 35, at 867; see also NOLLEN & AXEL, *supra* note 9, at 9-11 (estimating the contingent employee population at 25% of the American work force and explaining the difference as based upon the overcounting of permanent core workers who may be part time, and the failure to account for temporary help who are not secured through temporary help agencies). For a critical analysis of the alternative definitions given to contingent employment, see Gillian Lester, *Careers and Contingency*, 51 STAN. L. REV. 73, 78-86 (1998).

40. Surveys undertaken by the Conference Board in 1990 and 1995 indicated a growth from 12% to 35% of surveyed employers who expected that their work force would involve at least 10% contingent employee utilization in the near future. See *Employment: Global Companies Hiring More Temps; Trend Expected to Grow, Surveying Finds*, 1995 DAILY LAB. REP. (BNA) No. 180, at d21 (Sept. 18, 1995). Another survey revealed that 60% of employers increased their utilization of contingent workers over a five-year period. *Contingent Workers: Use of Contingent Workers Grows Over Five-year Span, Survey Finds*, 1996 DAILY LAB. REP. (BNA) No. 136, at d8 (July 16, 1996).

41. See JEREMY RIFKIN, *THE END OF WORK* 190 (1995) (reporting a total of 560,000 Manpower employees).

42. See LENZ, *supra* note 33, at 10-11.

43. See Vincent R. Johnson & Virginia Coyle, *On the Transformation of the Legal Profession: The Advent of Temporary Lawyering*, 66 NOTRE DAME L. REV. 359 (1990).

44. See Shella P. Calamba, *At Big Dailies, More News Jobs Are Temporary*, WALL ST. J., Aug. 26, 1996, at B1.

45. See G. Pascale Zachary, *Looking For a Real Rocket Scientist? Manpower to Offer Physicists as Temps*, WALL ST. J., Nov. 27, 1996, at A4.

46. See LENZ, *supra* note 33, at 11-12; Hammond, *supra* note 33, at 163-67.

Indeed, an employer may even decide to subcontract an entire assignment, such as guarding the employer's premises or operating a data processing center, or outsource core production tasks, despite the fact that these may be essential functions of the business.⁴⁷

Separately, if an employer does not wish to use the services of a firm specializing in providing workers, it may choose instead to directly contract with individuals for specific projects or for limited-term employment. Here, the individual will be an employee of the employer in all respects, but without the continuity which typifies traditional permanent employment.⁴⁸ Moreover, in such arrangements the employer has the option of avoiding a common law employment relationship entirely if enough independence is granted to the contracting worker so that he or she will be considered an independent contractor under common law standards.⁴⁹

Regardless of the specific form that the contingent employment relationship may take, such workers face serious problems in securing the various kinds of benefits the American work force has come to expect. The Bureau of Labor Statistics' survey of contingent employment, in particular, revealed that contingent employees are far more likely to work without fringe benefit programs as compared to traditional permanent workers.⁵⁰ While this may not be an issue for those who have benefits from some other source, such as an employed spouse or a professional organization, the problem can be a serious one if the contingent wage earner is entirely dependent on himself for economic support and has no other feasible way to secure affordable insurance or future retirement income.⁵¹

47. See generally Elizabeth MacDonald, *Big Consultants Broke Records in '97 Revenues*, WALL ST. J., June 15, 1998, at B13D; Christopher J. Sheehan, *Outsourcing Continues to Serve New Markets*, THE OFFICE, Sept. 1993, 46-47; *Canadian Auto Workers Target Outsourcing Trend*, WALL ST. J., July 20, 1998, at A16.

48. See NOLLEN & AXEL, *supra* note 9, at 186-87. Courts have held that contract employees are not protected against the non-renewal of their contracts, even if the reason for termination violates state public policy. *Luethans v. Washington Univ.*, 894 S.W.2d 169 (Mo. 1995) (en banc). Some courts have extended this result to include employees covered by collective bargaining agreements. See, e.g., *Egan v. Wells Fargo Alarms Serv.*, 23 F.3d 1444 (8th Cir. 1994); *Phillips v. Babcock & Wilcox*, 503 A.2d 36 (Pa. Super. Ct. 1986). See generally Berger, *supra* note 9.

49. Independent contractor status means that the employer is free from many of the regulations which pervade the employer-employee relationship, including the obligation to pay federal employment taxes. See NOLLEN & AXEL, *supra* note 9, at 188, 190-91. The Internal Revenue Service ("IRS") utilizes a 20-factor test to distinguish employees from independent contractors, Rev. Rul. 87-41, 1987-1 C.B. 296, and has published a training manual to assist in making the classification. INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY, *EMPLOYEE OR INDEPENDENT CONTRACTOR?* (1996).

50. BUREAU OF LABOR STATISTICS III, *supra* note 38, at 3-4 (reporting that one in five contingent workers had employer-provided health insurance compared to one in two traditional workers, and that only one in four contingent workers was eligible to participate in an employer-provided pension plan compared to nearly one-half of all traditional workers).

51. In fact, current estimates are that a total of approximately 44 million Americans, or one

The importance of workplace benefits in the American economy can be seen in the dramatic increase in the percentage that benefits represent of total employee compensation. According to U.S. Chamber of Commerce estimates, employee benefits accounted for 3% of total compensation paid to employees in 1929, but this figure had risen to 41.9% by 1996.⁵² While some of these costs represent required benefits, such as Social Security⁵³ and Unemployment Insurance,⁵⁴ others reflect programs which have become increasingly important in the contemporary economic environment, though not mandatory.

Among the workplace benefits Americans have become increasingly dependent upon are those that provide health insurance both for the individual and for his or her dependents. If health insurance coverage is provided in connection with employment, the employer will often contribute to the overall premium costs.⁵⁵ Even if that is not the case, the employer may be able to secure

out of every six, lack any medical insurance coverage whatsoever. This is an increase over the estimated 37 million who lacked medical insurance in 1993, and includes not only the unemployed, but also those whose employers have chosen to drop medical insurance for their employees. See Brian J. LeClair, *What About a Bill of Rights for the Uninsured?*, N.Y. TIMES, July 28, 1998, at A19. See also Edwin Chen, *Health Care Bill Travels Rugged Road of Reform*, L.A. TIMES, Feb. 4, 1996, at A1; *Insurance Reform Bill Takes Small Step in Right Direction*, MOD. HEALTHCARE, Aug. 12, 1996, at 25. Under the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), 29 U.S.C. §§ 1161-1168 (1994 & Supp. II 1996), a discharged employee may be entitled to continued medical insurance under the employer's medical plan for up to three years, but the cost must be born entirely by the employee, and that is likely to make it a severe economic burden for someone who has just lost his source of regular income. Individual Retirement Accounts ("IRAs") are available for workers who wish to put aside funds for retirement, but there is no required employer contribution and there is a \$2000 per year maximum for employee contributions. See I.R.C. § 408(a)(1) (1994). This may be a welcome additional retirement planning vehicle for some, but lower-end contingent employees are less likely to have excess money available for the purpose of retirement saving.

52. UNITED STATES CHAMBER OF COMMERCE, 1997 Employee Benefits Report, *reprinted* in MARK A. ROTHSTEIN & LANCE LIEBMAN, EMPLOYMENT LAW 456 (4th ed. 1998) [hereinafter 1997 Employee Benefits Report].

53. Federal Old-Age, Survivors, and Disability Insurance Benefits Act ("Social Security Act"), 42 U.S.C. §§ 401-433 (1994 & Supp. II 1996).

54. FUTA, I.R.C. §§ 3301-3311 (1994 & Supp. II 1996), *as amended* by I.R.C. §§ 3301-3311 (West Supp. 1998).

55. If conventional group insurance is used, premiums are transmitted to an insurance company that assumes all claim risks, although a high claim rate can be expected to lead to future premium increases. Alternatively, the company may self-insure and pay claims out of its own resources. In such cases, an outside contractor may be used to process claims, and stop-loss or excess risk insurance may be purchased to limit the employer's liability risk. AMERICAN BAR ASSOC. SECTION OF LABOR AND EMPLOYMENT LAW, EMPLOYEE BENEFITS LAW 1050-52 (1991) [hereinafter EMPLOYEE BENEFITS LAW]. Health care costs have been described as the "culprit" behind increases in total compensation costs for employees. See Duff, *supra* note 7. Increasing reliance on employee contributions, however, may be causing some to forgo participation in

the benefit of group rates, thereby lowering per person premiums. In any event the cost to the employer is a deductible expense,⁵⁶ which lowers the effective cost of the insurance coverage provided. Employees may also be able to pay their portion of medical expenses with pre-tax income if their employer maintains a qualified flexible spending account plan.⁵⁷ However, individuals who work for themselves are less likely to secure favorable group health insurance rates, and the tax code does not grant them full tax deductibility for premium costs.⁵⁸

Pension benefits are a second area where Americans have looked to the workplace for coverage. Since the 1930s, the Social Security program has been one way that individuals have secured an income source to meet economic needs during retirement.⁵⁹ However, as the baby boom generation approaches retirement age, Americans have become increasingly concerned about the ability of the government to maintain the Social Security system's financial solvency. In fact, many younger workers anticipate that Social Security will not meet their needs when they retire.⁶⁰ For this reason, alternative sources of retirement income have become increasingly necessary.

Many American employers are addressing the retirement needs of their employees by providing defined benefit or defined contribution retirement plans. Under the former, employees secure benefits at retirement determined by their salaries and years of service, while the latter involves individually-managed retirement accounts; employers typically fund both in whole or in part.⁶¹ The major difference is that defined contribution plans do not entail a guaranteed retirement benefit, thereby placing upon the individual retiree the entire risk of

employer-provided health insurance programs. See McGinley, *supra* note 4.

56. Employee health insurance is deductible as an ordinary and necessary business expense under I.R.C. § 162(a) (1994 & Supp. II 1996), amended by I.R.C. § 162(a) (West Supp. 1998).

57. See generally RESEARCH INSTITUTE OF AMERICA, BENEFITS COORDINATOR §§ 33,901-33,926 (1998); Mark Edwards, *Reduce Payroll Taxes with a Cafeteria Plan*, 82 ILL. B.J. 161 (1994); David Langer, *How a Flexible Spending Account Plan Works*, THE PRACTICAL ACCOUNTANT, Mar. 1989, at 77-78.

58. Self-employed individuals had been permitted to deduct 45% of their health insurance costs for tax years 1998 and 1999, rising to 50% in 2000, and ultimately to 100% in 2007. I.R.C. § 162(l)(1) (1994 & Supp. II 1996), amended by I.R.C. § 162(a) (West Supp. 1998). The budget bill passed by Congress and signed by the President in October 1998 retains the 45% deductibility limit for 1998, but raises it to 60% in 1999 through 2001, 70% in 2002, and 100% in 2003. See *Tax Report: Self-Employed Workers May Deduct More of Their Health Insurance Costs*, WALL ST. J., Oct. 28, 1998, at A1. Employees of staffing firms, however, would not necessarily meet the definition of a self-employed individual with earnings from self-employment. Consequently, they would be less likely to qualify for any tax deduction for health insurance premiums. See *infra* note 310 and accompanying text.

59. Social Security Act, 42 U.S.C. §§ 401-433 (1994 & Supp. II 1996). See generally ROTHSTEIN & LIEBMAN, *supra* note 52, at 1241-78.

60. See *supra* note 3.

61. See EMPLOYEE BENEFITS LAW, *supra* note 55, at 24-25 (1991); Peter T. Scott, *A National Retirement Income Policy*, 44 TAX NOTES 913, 919-20 (1989).

successful or unsuccessful investment decisions.⁶² For those employees whose adjusted gross income does not exceed statutory limits, it is also possible to plan for retirement by diverting up to \$2000 of their yearly salary to Individual Retirement Accounts ("IRAs").⁶³ However, like defined contribution retirement plans, IRAs place responsibility for managing investment choices upon the retiree. Moreover, the role of IRAs is limited because of their restricted income eligibility criteria and the fact that they are entirely employee-funded.

While health insurance and pension benefits may be of special importance given their critical character, many other benefits are frequently tied to employment. Obviously this is true for paid time off from work for sick leave and vacations. Employers may also provide employees with life insurance at group rates, either entirely or partially paid for by the company.⁶⁴ In order to accommodate the family needs of its employees, companies may provide such benefits as day care and leaves of absence. Companies have also sought to make employees a part of the firm's ownership structure by providing options for stock purchases at discounted prices.⁶⁵ Even these, however, do not exhaust the variety of workplace benefits many employers now provide.

Although Americans associate the workplace with various benefits they have come to rely upon, that association has had only limited legal support. Even with respect to traditional full-time permanent employees, there are only a limited number of situations in which the law compels an employer to provide benefits to his work force. At the federal level, legislation mandates employee participation in the Social Security and Unemployment Insurance programs.⁶⁶ Otherwise, mandated benefits are the exception rather than the rule.⁶⁷ As a society we have generally chosen not to require by law that employers compensate their employees over and above the wages and salaries due for

62. The employer's potential liability for offering investment options which perform poorly or for failing to provide sufficient information about investment risks is unclear. See *In re Unisys*, 74 F.3d 420 (3d Cir. 1996), *cert. denied*, 117 S. Ct. 56 (1996); ROTHSTEIN & LIEBMAN, *supra* note 52, at 1196-97.

63. Regular IRAs are characterized by the exclusion from income taxation of the initial contribution when made, followed by full income taxation of all distributions. I.R.C. § 408 (1994 & Supp. 1996), *amended by* I.R.C. § 408 (West Supp. 1998). In contrast, there is no income tax exclusion for contributions to a Roth IRA, but there is also no income taxation applicable to ultimate distributions, including all earnings on the original contributions. I.R.C. § 408(A) (West Supp. 1998).

64. The U.S. Chamber of Commerce reported that employers spend 0.4 cents-per-hour on employee life insurance and death benefits. 1997 Employee Benefits Report, *supra* note 52.

65. See *supra* notes 5-6.

66. See *supra* notes 53-54.

67. Hawaii's mandated employer-provided health insurance is a prominent exception. HAW. REV. STAT. § 21-393 (1985). Another example is the Maine statute requiring severance payments following a plant closing. ME. REV. STAT. ANN. tit. 26, § 625-B (West 1988). The statute was upheld by the Supreme Court against a challenge that it was preempted by ERISA and the National Labor Relations Act. See *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1 (1987).

services rendered.

Nevertheless, benefits have become a common feature of the employment landscape. To at least some extent, this development was encouraged by the wage and price control system put in place during World War II.⁶⁸ Applicable regulations at the time made it impossible to compete for workers by offering higher wages, but benefit increases were not deemed in violation of the wage and price control system.⁶⁹ Employers took advantage of this opportunity and in so doing stimulated the growth of benefit plans as part of the total compensation package employees have come to expect.⁷⁰ Pension benefit plans experienced significant growth in the period following World War II after the National Labor Relations Board ("NLRB"), with court approval, ruled that pension issues could not be excluded from collective bargaining negotiations.⁷¹ Further stimulation arose from the growing general belief in the advantages of pension programs as a means of securing a worker's allegiance to his or her employer.⁷²

However, at the same time that the public has grown to expect some benefit mixture as part of their compensation package, employers have discovered how increasingly expensive it is to provide such a package. The skyrocketing cost of health care is the primary driving force behind the cost increases,⁷³ but the pressure for an increasing array of benefits is also a factor.⁷⁴ Some employers

68. Emergency Price Control Act of 1942, 56 Stat. 23.

69. ALICIA HAYDOCK MUNNELL, *THE ECONOMICS OF PRIVATE PENSIONS* 7-12 (1982), reprinted in ROTHSTEIN & LIEBMAN, *supra* note 52, at 1169.

70. See Cantoni, *supra* note 7 (observing that the 1942 Stabilization Act "permitted the adoption of employer-paid insurance plans in lieu of wage increases").

71. *Inland Steel Co.*, 77 N.L.R.B. 1 (1948), *enforced*, 170 F.2d 247 (7th Cir. 1948), *cert. denied*, 336 U.S. 960 (1949). See generally Note, *Pension and Retirement Matters—A Subject of Compulsory Collective Bargaining*, 43 ILL. L. REV. 713 (1948).

72. In a survey of 3381 employed men and women, 52% of the workers who were not offered health insurance benefits said they would change employers to obtain such benefits. See Richard L. Hannah, Ph.D., *The Tradeoff Between Worker Mobility and Employer Flexibility: Recent Evidence and Implications*, EMPLOYEE BENEFITS J., June 1994, at 23.

73. After a period of dramatic health care cost increases, followed by some moderation due to the growth of managed care and other cost control measures, health care costs may be on the increase again. See Hau, *supra* note 7. Drug prices may also be rising. See Elyse Tanouye, *Drugs: Behind the Inflation in Prescription-Drug Prices*, WALL ST. J., July 6, 1998, at A17. As much as 52% of employer's profits go to cover the cost of medical care. See Lee Sands, *Once Faddish Wellness Plans Now Standard at Large Firms*, DENV. BUS. J., June 28, 1991, at 25.

74. Probably the most significant area in which pressure exists to expand benefits concerns the extension of benefits to gay and lesbian partners of covered employees. This has been the subject of litigation and voluntary employer policy changes. See, e.g., *Rovira v. American Tel. & Tel.*, 817 F. Supp. 1062 (S.D.N.Y. 1993) (litigating the issue that company death benefits were denied to employee's same sex partner); Mark W. Davis, *Catholic Church Resists San Francisco's Gay Agenda*, WALL ST. J., Feb. 5, 1997, at A19 (discussing San Francisco's ordinance requiring employers doing business with the city to provide equivalent benefit treatment for non-heterosexual domestic partners of employees); *IBM Is Extending Health Benefit Plan to Partners of Gays*, WALL

have responded to this by increasing overtime wherever possible in lieu of hiring new workers because overtime compensation at time and one-half the employee's regular rate will often be less expensive than the cost of providing benefits to a new worker.⁷⁵ Others have discontinued benefits as a response to the problem, but taking such a step may serve to undercut the loyalty and commitment required of key personnel. Another way to deal with high benefit costs is to create a two-tier employment structure in which only a limited number of employees work in the traditional pattern of a continuous job with typical wage-connected benefits, while others are hired on a contingent basis without benefits. On the shop floor the two groups may be virtually indistinguishable, but the pay stubs they receive will be vastly different.

While some workers may be content with a second-tier employment environment, the reality of a job that does not offer health insurance and has no provision for retirement savings may be disastrous for others. To the extent such workers have looked to the law for relief, they have generally found that employers are free to divide the work force into haves and have-nots. Courts have left employers with the discretion to choose what kind of benefits to offer, if any, and to designate who the beneficiaries will be.⁷⁶ Existing legislation has not been viewed as an obstacle to virtually complete employer freedom of choice in making benefit eligibility decisions. However, this pattern has been called into question as a result of two important court rulings, one from the Ninth Circuit Court of Appeals involving the Microsoft Corporation,⁷⁷ and another from the U.S. Supreme Court addressing the statutory ban against interference with the securing of ERISA program benefits.⁷⁸ Each of these decisions identify troublesome contingent employee benefit problems that existing law may not adequately resolve.

ST. J., Sept. 20, 1996, at B5 (discussing the extension of health benefits to gay and lesbian partners of employees).

75. See *Factories Keep Lid on Hiring Despite Overtime Levels*, 155 Lab. Rel. Rep. (BNA) 269, 271 (June 30, 1997); *Autos: UAW Strike at Michigan Truck Plant Over Staffing Levels Idles 5,900 Workers*, 1997 Daily Lab. Rep. (BNA) No. 80, at A3 (Apr. 25, 1997).

76. "ERISA does not mandate that employers provide any particular benefits, and does not itself proscribe discrimination in the provision of employee benefits." *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 91 (1983). Relying on this principle, the court in *McGann v. H & H Music Co.*, 946 F.2d 401 (5th Cir. 1991), cert. denied, 506 U.S. 981 (1992), permitted the employer to alter the company's \$1 million lifetime medical coverage to incorporate a \$5000 limit for AIDS-related claims. However, benefit plan changes must be made pursuant to a procedure contained in the plan which includes the identification of those with the authority to make the changes. See *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73 (1995).

77. *Microsoft Corp. I*, 97 F.3d 1187 (9th Cir. 1996), *aff'd on reh'g*, *Microsoft Corp. II*, 120 F.3d 1006 (9th Cir. 1997) (en banc), cert. denied, 118 S. Ct. 899 (1998).

78. *Inter-Modal Rail Employees Ass'n v. Atchison, Topeka and Santa Fe Ry. Co.*, 117 S. Ct. 1513 (1997).

II. JUDICIAL RESPONSES TO CONTINGENT EMPLOYEE BENEFIT CLAIMS

A. *The Microsoft and Inter-Modal Rail Employees Ass'n Cases*

The dispute in the *Microsoft*⁷⁹ cases grew out of Microsoft's utilization of a two-tier employment structure. Microsoft maintained a core of permanent employees who received such benefits as paid vacation, sick leave, holidays, short-term disability, group health and life insurance, stock options and pensions. It supplemented its core work force with a separate group of contract workers whom it labeled "freelancers." In contrast to the company's regular employees, Microsoft's freelancers did not receive any company-provided benefits.⁸⁰

Microsoft attempted to maintain a distinction between its core employee staff and the freelance work force, even though freelancer work functions were fully integrated with those of the company's regular workers.⁸¹ For example, the freelancers wore different color badges, had different electronic mail addresses, were given a less formal orientation and were not invited to official company functions. Moreover, after submitting invoices for services, they were paid through the accounts receivable department without any deductions for withholding and employment taxes, as compared to Microsoft's traditional employees who received their paychecks from the payroll department after all such deductions had been made.⁸² Finally, when hired, the freelancers were specifically informed that they were not employees and would receive no benefits. They were required to sign an agreement which included the statement that "as an Independent Contractor to Microsoft, you are self employed and are responsible to pay all your own insurance and benefits."⁸³

Microsoft's work force structure first ran into difficulty when it was audited by the Internal Revenue Service ("IRS"). Using common law standards, the IRS concluded that the freelancers were employees for purposes of withholding and employment taxes.⁸⁴ Microsoft paid the required taxes and issued retroactive W-2 forms to the freelancers,⁸⁵ but then restructured the relationship in an attempt to avoid comparable problems in the future. It did this by requiring the freelancers to enter into a relationship with a temporary employment agency which would administer federal income tax withholding and pay all employment

79. *Microsoft Corp. I*, 97 F.3d 1187 (9th Cir. 1996). The basic analysis of the panel opinion was affirmed in the en banc Ninth Circuit ruling, although the case was remanded to the benefits plan administrator for consideration of the Microsoft theory which had not previously been presented at that level. *Microsoft Corp. II*, 120 F.3d 1106, 1015 (9th Cir. 1997) (en banc).

80. *Microsoft Corp. I*, 97 F.3d at 1189-90.

81. *See id.* at 1190.

82. *See id.* The freelancers would document their hours and the projects on which they worked in the invoices they submitted. They were paid in much the same manner that a contractor providing supplies to Microsoft would have been paid. *See id.*

83. *Id.*

84. *See id.*

85. *See id.* at 1190-91.

taxes.⁸⁶

A number of former freelancers then sought various company benefits, which Microsoft's benefits plan administrator denied.⁸⁷ The plaintiffs did not pursue their claims for such benefits as vacation, sick leave, holidays, and short-term disability, but they did pursue claims challenging the denial of two specific benefits, the Microsoft deferred salary plan to which the company contributed 50% up to a maximum and the employee stock purchase plan that allowed employees to purchase company stock at a reduced price, up to a specified limit.⁸⁸

The parties agreed that the deferred compensation plan was a welfare benefit plan covered by ERISA, and that the plaintiffs' eligibility to participate was governed by federal law.⁸⁹ The plan's eligibility rules provided that each "employee" over eighteen years of age with more than six months of service could participate, and went on to define the word employee as meaning "any common law employee who receives remuneration for personal services rendered to the employer and who was on the United States payroll of the employer."⁹⁰ The Company did not dispute the plaintiffs' satisfaction of all but one of the eligibility criteria, including the fact that the plaintiffs were common law employees. The only contested issue was the question of whether the freelancers were on Microsoft's U.S. payroll. The plaintiffs maintained that the relevant language extended coverage to all employees paid from U.S. sources, while Microsoft insisted that only those paid through the payroll department were covered.⁹¹

Both ERISA legal principles and the unique procedural character of the litigation contributed to Microsoft's ultimate loss before a panel of the Ninth Circuit Court of Appeals. Under ERISA, decisions of a plan administrator or fiduciary are subject to review under an abuse of discretion standard where the plan administrator or fiduciary is given discretionary authority to determine eligibility. If the plan is not structured in such a fashion, plan administrator decisions are reviewed *de novo*.⁹² Unfortunately for Microsoft, the panel concluded that the abuse of discretion standard applicable to benefit plans that vest discretion in the plan administrator would not be applied regardless of the structure of Microsoft's benefit plan system because the question at issue, namely the meaning of the plan eligibility phrase, "on the United States payroll of the employer," had not been presented to the plan administrator.⁹³ At that stage of the proceedings the company had relied upon the independent contractor

86. *See id.*

87. *See id.* at 1191.

88. *See id.*

89. *See id.* at 1192.

90. *Id.*

91. *See id.* at 1192-93.

92. *See* Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 102 (1989); EMPLOYEE BENEFITS LAW, *supra* note 55, at 509-13.

93. *Microsoft Corp. I*, 97 F.3d at 1193.

agreements to justify its decision to deny the plaintiffs' demand to participate in the plan. Moreover, once the dispute reached federal court, both parties agreed that a remand to the plan administrator would not be necessary.⁹⁴ Accordingly, the Ninth Circuit panel concluded that it should exercise its review authority on the assumption that the plan administrator had no discretion to review the plan. This meant that the court was free to consider the issue *de novo*.⁹⁵

Using general principles of contract interpretation, the Ninth Circuit panel observed that both the plaintiffs' and Microsoft's reading of the deferred compensation plan eligibility standards were reasonable.⁹⁶ It then concluded that since there was no extrinsic evidence favoring one interpretation over the other, the eligibility criteria should be interpreted against the drafter, leading to the result that freelancers were deemed eligible for participation in the plan.⁹⁷ However, the court emphasized that this result was not dictated by the provisions of ERISA, but rather was due to the ambiguous language contained in the Microsoft plan document.⁹⁸ It explicitly noted its agreement with the magistrate judge who had earlier concluded that the company "could easily have accomplished the limitation it now urges through the use of more explicit language."⁹⁹ In other words, Microsoft was not barred by law from excluding its freelancers from eligibility in the deferred compensation plan, but had simply failed to draft satisfactory language to accomplish that objective.¹⁰⁰

In contrast to the deferred compensation plan, the parties agreed that the stock purchase plan was not subject to ERISA, but rather was governed by state law.¹⁰¹ The starting point, once again, was the language used in the relevant plan document. The section of the plan at issue provided:

It is the intention of the Company to have the Plan qualify as an 'employee stock purchase plan' under Section 423 of the Internal Revenue Code of 1954. The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner

94. *Id.*

95. *Id.*

96. *Id.* at 1194.

97. *Id.* at 1196. For an illustration of the impact of using the deferential abuse of discretion standard in reviewing plan administrator eligibility determinations, see *Trombetta v. Cragin Federal Bank for Savings Employee Stock Ownership Plan*, 102 F.3d 1435 (7th Cir. 1996).

98. *Microsoft Corp. I*, 97 F.3d at 1196.

99. *Id.*

100. After the *Microsoft* ruling, one commentator observed:

Nothing in the [*Microsoft*] decision requires customers to provide benefits to staffing firm employees. Even if staffing firm employees assigned to a customer could be considered in a particular case to be the customer's employees, the customer can deny coverage if its plan excludes them in clear and explicit language.

LENZ, *supra* note 33, at 28.

101. See *Microsoft Corp. I*, 97 F.3d at 1196.

consistent with the requirements of that Section of the Code.¹⁰²

And as the court recognized, § 423 requires that “options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation.”¹⁰³ This led the court to conclude that the plaintiffs were entitled to participate in the plan.¹⁰⁴ The court reasoned that the plaintiffs were common law employees, § 423 of the Internal Revenue Code required that all common law employees be granted stock options under the type of plan at issue, and the plan itself had the objective of being in compliance with § 423 of the Code.¹⁰⁵

Although Microsoft argued that the provisions of the Internal Revenue Code did not grant the plaintiffs a private right of enforcement,¹⁰⁶ the court concluded that this argument was largely irrelevant. The plaintiffs were seeking participation in the benefit plan based upon the plan document’s language which the drafters had written to incorporate the standards of the Internal Revenue Code.¹⁰⁷ In short, the plaintiffs were seeking to enforce the provisions of the plan, not those of the Internal Revenue Code. Even the fact that the plaintiffs signed documents that excluded them from coverage was not controlling since those documents were in conflict with the language of the plan which expressly incorporated § 423 of the Code.¹⁰⁸

The dispute between Microsoft and its freelancers, however, did not end with the panel ruling. Instead, the case was heard by the Ninth Circuit Court of Appeals sitting en banc.¹⁰⁹ Initially, the en banc opinion concluded that the Microsoft freelancers were common law employees, a point that the company

102. *Id.* at 1197.

103. I.R.C. § 423(b)(4) (1994).

104. *Microsoft Corp. I*, 97 F.3d at 1197.

105. *Id.*

106. There is no specific provision in the Internal Revenue Code allowing individuals to pursue litigation to collect federal taxes which might be owed. However, the issue of a private right to enforce federal law arose in the context of the Federal Elections Campaign Act Amendments of 1974. In *Cort v. Ash*, 422 U.S. 66 (1975), the Supreme Court ruled that no private right of action was created by Congress to enforce the statute. The Court’s ruling was based upon consideration of whether: (1) the plaintiff is one of the class for whose special benefit the statute was enacted; (2) there is any indication of legislative intent either to create or deny a private remedy; (3) a private remedy would be consistent with the underlying purposes of the legislative scheme; and (4) the cause of action is one traditionally relegated to state law so that it would be inappropriate to infer a cause of action based solely on federal law. *Id.* at 78. Relying upon this analysis, it has been held that ERISA does not create a private remedy to challenge an employer’s creation of a ‘top-heavy’ retirement plan which would violate Internal Revenue Code standards for securing favorable tax treatment. See *Trenton v. Scott Paper Co.*, 832 F.2d 806, 809 (3d Cir. 1987), *cert. denied*, 485 U.S. 1022 (1988).

107. See *Microsoft Corp. I*, 97 F.3d at 1197.

108. *Id.* at 1198-99.

109. *Microsoft Corp. II*, 120 F.3d 1006 (9th Cir. 1997) (en banc).

itself had not contested,¹¹⁰ and that the misclassification of the freelancers as independent contractors was a mistake rather than an intentional violation of governing legal principles.¹¹¹ The court then reasoned that the status of the freelancers as potential deferred compensation program participants had to be determined by the coverage provided in the plan documents because it could not be governed by the erroneous independent contractor classification decision, even though the freelancers had signed independent contractor agreements acknowledging that they were ineligible to participate in any company benefit plan.¹¹² The court's ruling on these issues paralleled the decision of the Ninth Circuit panel.

The freelancers' claim for deferred compensation had already been considered by the benefits plan administrator for Microsoft, and had been ruled invalid.¹¹³ However, that ruling was based upon the erroneous classification of the freelancers as independent contractors.¹¹⁴ The en banc court concluded that this was reversible even under the flexible arbitrary or capricious standard of review.¹¹⁵ Once the dispute reached the courts, however, Microsoft substituted its new legal theory that benefit eligibility was properly denied because the freelancers were paid by the accounts receivable department rather than payroll.¹¹⁶ But rather than reject this argument as the Ninth Circuit panel had done, the court sitting en banc determined that the company's new theory should be referred back to the benefits plan administrator for a decision.¹¹⁷ Although the court did not explicitly address the issue, presumably this would mean that the plan administrator's ruling would only be reversible for abuse of discretion rather than subject to the de novo review standard applied by the Ninth Circuit panel.¹¹⁸ Although the court cautioned the benefits plan administrator to "pay careful attention" to the decision of the Ninth Circuit panel, the en banc court nevertheless concluded that it was the plan administrator who had the "primary duty of construction."¹¹⁹

In contrast to its decision to remand the claim for participation in the deferred compensation plan, the Ninth Circuit en banc ruling affirmed the panel's conclusion that the freelancers were entitled to participate in the Microsoft stock

110. *Id.* at 1010.

111. *Id.* at 1011.

112. *Id.* at 1012-13.

113. *See id.* at 1013.

114. *See id.*

115. *Id.*

116. *See id.*

117. *Id.* at 1013-14.

118. At the beginning of its decision the en banc court took pains to restate the abuse of discretion review standard applicable to discretionary decisions of plan administrators. *Id.* at 1009.

119. *Id.* at 1013. In contrast, Judge Fletcher, writing for seven members of the en banc panel, argued that a remand to the benefits plan administrator was inappropriate on the grounds that a plan should "not be permitted to assert on judicial review reasons for denial that were not contained in the plan administrator's decision." *Id.* at 1016.

purchase plan. It viewed the company as having extended the plan to its employees in return for services rendered and as a means to insure a productive work force.¹²⁰ In the court's view, the fact that Microsoft's officers mistakenly concluded that the freelancers were not covered employees did not change the fact that the Microsoft offer was accepted by the workers through their labor.¹²¹ All that was left, according to the court, was for the district court to determine an appropriate remedy.¹²²

Even if the plaintiffs in the *Microsoft* case are successful in securing benefits from the deferred compensation plan as well as the stock purchase program, the message of the decision is merely that benefit plan language must be carefully written if the employer seeks to exclude contingent employees. Neither decision indicates that an employer decision to exclude contingent employees from benefit plan eligibility is prohibited by law. This raises the distinct possibility that employers will conclude that they can achieve significant cost reductions through the elimination of workplace benefits by converting their workers into contingent employees.¹²³ However, the extent to which the law permits the outright replacement of permanent workers by alternative service providers is somewhat uncertain.

Aspects of this problem were addressed by the Supreme Court in *Inter-Modal Rail Employees Ass'n v. Atchison, Topeka & Santa Fe Railway Co.*¹²⁴ As part of a cost reduction program, the company had decided to subcontract the work of transferring cargo between railcars and trucks.¹²⁵ Many of its employees, who previously had performed the work directly, were then hired by the subcontractor.¹²⁶ Under this new contractual arrangement, the subcontractor was not required to make contributions under the Railroad Retirement Act, and it provided a total benefit package that was inferior to what the employees previously received.¹²⁷ As a result of the reduction in their benefits, the employees filed suit alleging that their original employer had discharged them "for the purpose of interfering with the attainment of any right to which such participant may become entitled under"¹²⁸ the original welfare and benefit plans in violation of section 510 of ERISA.¹²⁹

The Ninth Circuit Court of Appeals had held that the plaintiffs stated a valid claim with respect to pension benefits because section 510 of ERISA "protects plan participants from termination motivated by an employer's desire to prevent

120. *Id.* at 1014.

121. *Id.* at 1014-15.

122. *Id.* at 1015.

123. *See supra* note 10.

124. 117 S. Ct. 1513 (1997).

125. *See id.* at 1514.

126. *See id.*

127. *See id.* at 1514-15.

128. *Id.* at 1515.

129. 29 U.S.C. § 1140 (1994).

a pension from vesting.”¹³⁰ This ruling was not disturbed by the Supreme Court. In addition, the Ninth Circuit had concluded that no valid claim was stated under section 510 with respect to welfare benefit rights because such rights are not subject to the vesting requirements of federal law.¹³¹ The Supreme Court, in contrast, found this aspect of the Ninth Circuit decision erroneous.¹³²

The Ninth Circuit ruling was based upon the fact that ERISA, which establishes a system for the vesting of pension benefits, does not provide comparable treatment for welfare benefits.¹³³ Consequently, employers have the right to unilaterally terminate welfare benefits and employees have no rights under such plans to question an employer’s alleged interference with them.¹³⁴ However, the Supreme Court concluded that the plain language of section 510 indicated that there is no distinction between welfare and pension benefits for purposes of the statute’s ban against interference with the attainment of ERISA rights.¹³⁵ Welfare plans are included with pension plans in the statute’s definition of covered plans, and if Congress had wanted to distinguish between the two for purposes of section 510 it could have used the term pension plan or non-forfeitable plan in describing the extent of the section’s coverage.¹³⁶

The Court recognized that welfare benefit plans are not subject to vesting requirements, and may be amended or terminated without violating ERISA’s standards.¹³⁷ However, this requires that the plan contain procedures to be followed in cases of plan amendment or termination.¹³⁸ Employers must adhere to these procedures to alter or terminate their benefit plans, and cannot circumvent this obligation by defeating employee expectations in other ways.

130. *Inter-Modal Rail Employees Ass’n v. Atchison, Topeka & Santa Fe Ry. Co.*, 80 F.3d 348, 350-51 (1996) (quoting *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 143 (1990)).

131. *See Inter-Modal Rail Employees Ass’n*, 117 S. Ct. at 1515.

132. *Id.* at 1516.

133. ERISA establishes minimum vesting standards for pension plans. The basic requirement is that pension rights become non-forfeitable in their entirety after five years of service (cliff vesting) or on a percentage basis over a five-year period (20% after three years of service, rising to 100% after seven years of service). Multi-employer plans pursuant to collective bargaining agreements are permitted to use ten-year vesting periods. *See* 29 U.S.C. § 1053 (1994 & Supp. II 1996). In contrast, welfare benefit plans do not vest. One set of commentators explains that this is based upon the fact that welfare benefit programs are generally ‘current account’ or ‘pay as you go,’ with participants either using or declining the benefits. They are “too short-term in character to have attracted much in the way of long-term service conditions” and therefore “vesting protections have not been thought necessary.” JOHN H. LANGBEIN & BRUCE A WOLK, *PENSION AND EMPLOYEE BENEFIT LAW* 508 (2d ed. 1995).

134. *See Inter-Modal Rail Employees Ass’n*, 80 F.3d at 351.

135. *Inter-Modal Rail Employees Ass’n*, 117 S. Ct. at 1515.

136. *See id.*

137. *Id.* at 1516.

138. *See* 29 U.S.C. § 1102(b)(3) (1994); *see also* *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 84-85 (1995) (holding that general language reserving the company’s right to terminate or amend a plan is sufficient to satisfy ERISA).

Arguably, this would occur if an employer indirectly amended the plan by terminating its work force while having them continue to perform the same functions as employees of a subcontractor who did not provide equivalent benefits. This could constitute the effective discharge of employees for the purpose of interfering with their attainment of plan rights that section 510 prohibits.¹³⁹ However, the Court specifically declined to rule on the company position that section 510 is not violated in cases where an employee is already eligible to receive benefits on the theory that benefit 'attainment' already exists; the case was remanded to allow the Ninth Circuit to consider this argument.¹⁴⁰ As a result, *Inter-Modal* only decided that ERISA's anti-interference provision applied to all covered benefits, leaving the question of what constitutes prohibited interference unresolved.

B. *Alternative Judicial Approaches to Mandatory Benefits*

The outcome of the Supreme Court's *Inter-Modal* decision and the Ninth Circuit Court of Appeals rulings in *Microsoft* was the rejection of the employers' positions that there could be no obligation to provide benefits to the contingent employee plaintiffs. Conversely, the decisions suggested the possibility that employers may have a legal duty, in some circumstances, to provide contingent employees with the same benefits made available to members of the permanent work force. Yet, the traditional view held that an employer is not required to provide benefits beyond those which are mandated by law. One commentator states definitively that no benefit obligations arise with respect to contingent employees.¹⁴¹ However, while it is true that benefit claims by contingent employees have usually been unsuccessful, there are some exceptions. Moreover, even where there is no obligation to provide benefits, other consequences may make this outcome problematic.

The principle that employers are not obligated to provide benefits to contingent employees is illustrated by the ruling of the Fourth Circuit Court of Appeals in *Clark v. E. I. DuPont de Nemours & Co.*¹⁴² There the claimant, who had been a DuPont employee for eight years, was terminated following the closing of his division.¹⁴³ Subsequently, he performed occasional contract work for DuPont, and later was hired by a leasing firm which assigned him to work on

139. A critical issue in this analysis is the requirement that the company action be taken for the purpose of interfering with the attainment of rights protected by ERISA. The Court recognized that this prohibited purpose might not be present if the employer acts in the course of "making fundamental business decisions," but its opinion shed no light on the meaning of this distinction. *Inter-Modal Rail Employees Ass'n*, 117 S. Ct. at 1516.

140. *Id.* at 1516-17.

141. LENZ, *supra* note 33, at 21.

142. 105 F.3d 646, No. 95-2825, 1997 WL 6958 (4th Cir. Jan. 9, 1997) (unpublished disposition), *cert. denied*, 117 S. Ct. 2425 (1997).

143. *See id.* at *1.

a DuPont contract.¹⁴⁴ He participated in the leasing company's benefit programs, but none of them were directly funded by DuPont.¹⁴⁵ When the leasing company lost its DuPont contract, the claimant sought benefits under the DuPont plan.¹⁴⁶

The court was prepared to assume that the claimant met the standards for classification as a common law DuPont employee. Nevertheless, it upheld the decision to deny him the right to participate in the benefit program, relying principally upon the benefit plan document provisions which limited participation to "any person designated by the Company as a full-time employee. Any full service employee on the role [as of December 1, 1985] who continues to work at least [twenty] hours per week on a regular basis will be considered a Full Service Employee."¹⁴⁷ With respect to the company's stock ownership program, as well as its the savings and investment plan, the court recognized that all employees, including leased workers, had to be counted for purposes of determining participation rates in order to qualify for favorable tax treatment.¹⁴⁸ Nevertheless, all relevant plan documents expressly excluded leased employees from benefit program eligibility, and the court found this fact controlling. The court concluded that the plaintiff's claim was properly denied because the plaintiff was a leased employee expressly excluded from plan participation, with neither the provisions of ERISA nor those of the Internal Revenue Code requiring a contrary result.¹⁴⁹

In *Abraham v. Exxon Corp.*,¹⁵⁰ the Fifth Circuit Court of Appeals faced a similar claim for benefit plan participation by a leased employee who was expressly excluded by the relevant plan documents. In support of his claim, the plaintiff cited the minimum participation and coverage requirements for plans established by both ERISA and Treasury Department regulations.¹⁵¹ The court

144. *See id.*

145. *See id.*

146. *See id.*

147. *Id.* at *3.

148. *Id.* The prohibition against tax favored status for 'top heavy' plans which unduly favor highly compensated personnel cannot be circumvented through the use of leased workers. Leased workers must be counted in determining whether the company's plan is top heavy. *See* I.R.C. § 414(n) (1994 & Supp. II 1996), *amended by* I.R.C. § 414 (West Supp. 1998); *see also infra* notes 269-78 and accompanying text.

149. *Clark*, 1997 WL 6958, at *3 n.2. The court observed that the term 'employee' must include leased workers "solely for tax purposes." Additionally, the court rejected the idea that ERISA requires that any particular employee be included in the benefit plan as long as the exclusion is not based on prohibited age or length of service considerations. *Id.* at *4. Benefit plan participation must therefore be determined on the basis of the relevant plan documents, and *Clark* was simply "not eligible to receive benefits under the plain language of the Plans." *Id.* at *5.

150. 85 F.3d 1126 (5th Cir. 1996).

151. *See id.* at 1130-31. The plaintiff relied upon 29 U.S.C. § 1052(a)(1)(A) (1994) and 26 C.F.R. § 1.410(b)-(4)(c)(3) (1998) as the basis for the argument that pension plans may not discriminate against leased workers who otherwise fit the definition of a common law employee under applicable legal criteria. *See id.* at 1130.

rejected this position concluding that the relevant provisions of ERISA did not bar discrimination against leased employees.¹⁵² Moreover, it held that the Treasury Department regulations relied upon by the plaintiff only served to determine the eligibility of the plan for favorable tax treatment.¹⁵³ In short, neither ERISA nor relevant tax law provisions created an enforceable right to plan participation for leased employees.

More recent district court decisions in Kansas and Iowa, as well as a ruling by the Seventh Circuit Court of Appeals, have added further weight to the position that contingent employees have no inherent right to claim benefits from their employer. The Kansas case, *Capital Cities/ABC, Inc. v. Ratcliff*,¹⁵⁴ involved a claim for ERISA benefits made by newspaper carriers for *The Kansas City Star* and *Kansas City Times* newspapers. The carriers had signed agreements stating that they were self-employed independent contractors and acknowledged that they would “not receive, and [have] no claim to, any benefits or other compensations currently paid” to the company's employees.¹⁵⁵ For the court, the carriers' acknowledgment that they were ineligible for the company's benefit plan was sufficient to justify denial of their claim even if they met the standard for classification as common law employees. In effect, they had contracted away any right they might otherwise have had to participate in the company's benefit plan.¹⁵⁶ In addition, the rejection was supported by the fact that the carriers were not eligible employees under the relevant plan documents.¹⁵⁷

In *Coonley v. Fortis Benefit & Insurance Co.*,¹⁵⁸ an Iowa federal district court ruling produced the same result for an independent contractor who sought

152. *Abraham*, 85 F.3d at 1130-31.

153. *Id.* at 1131.

154. 953 F. Supp. 1228 (D. Kan. 1997), *aff'd*, 141 F.3d 1405 (10th Cir. 1998).

155. *Id.* at 1231.

156. *See id.* 1234-35. In contrast, both the Ninth Circuit Court of Appeals panel and the en banc panel in the *Microsoft* cases did not consider controlling the fact that the freelancers for Microsoft had signed agreements acknowledging that, as independent contractors, they were ineligible for benefits because they were in fact common law employees. *Microsoft Corp. I*, 97 F.3d 1187, 1194-95 (9th Cir. 1996), *aff'd on reh'g*, *Microsoft Corp. II*, 120 F.3d 1006, 1010-12 (9th Cir. 1997) (en banc).

157. There were four ERISA benefit plans and each contained eligibility criteria which did not apply to the carriers. *Capital Cities/ABC, Inc.*, 953 F. Supp. at 1235-36. *Microsoft* was distinguished on the grounds that the relevant eligibility criteria in Microsoft's plan allowed participation for common law employees, a status met by the freelancers despite the contract they signed labeling themselves independent contractors. *Id.* at 1236. Subsequently, the Tenth Circuit Court of Appeals affirmed the district court conclusions that the claimants were properly denied benefits because they signed documents acknowledging their ineligibility and they did not meet the eligibility criteria of the relevant plans. *Capital Cities/ABC, Inc. v. Ratcliff*, 141 F.3d 1405, 1412 (10th Cir. 1998).

158. 956 F. Supp. 841 (N.D. Iowa 1997), *aff'd*, 128 F.3d 675 (8th Cir. 1997) (per curiam).

benefits under an employee life insurance policy.¹⁵⁹ Finally, in *Trombetta v. Cragin Federal Bank for Savings Employee Stock Ownership Plan*,¹⁶⁰ the Seventh Circuit Court of Appeals upheld the denial of benefits to bank loan originators who had signed documents agreeing that they were to be considered “independent contractors and not employee . . . for all purposes,”¹⁶¹ in light of the fact that benefit plan participation was limited to “employees.”¹⁶²

The *Microsoft* decision and rulings that support employers in their denial of workplace benefits to contingent employees, focus upon contract principles in determining benefit eligibility. The “contract” is the employer benefit plan along with any documents the contingent employee may have signed as a condition of employment. The benefit plan document will in some fashion define those who are eligible for participation, often simply by identifying the members of the labor force who may participate in the benefit program at issue. Coverage is then judged by evaluating the claimant’s eligibility pursuant to the plan definition, or by an assessment of whether he has waived the right to participate.¹⁶³

Of course, the more specific the plan document, the less likely it is that coverage problems will arise in the future. For example, the document might specify that covered individuals include all common law employees working a specified number of hours per week for a specified number of weeks per year. However, even a description in this form may ultimately prove inadequate as

159. Critical to the *Coonley* court’s conclusion that benefits were properly denied was its judgment that the claimant did not meet the standards for classification as an employee, and only employees were entitled to benefit program participation. *Id.* at 858-60. In the court’s words, since the claimant “was not an employee of [the corporation] within the meaning of the Plan, [and b]ecause ‘employee’ status is required for coverage under the Plan . . . ,” summary judgment for the employer was appropriate. *Id.* at 860. The district court decision was affirmed in a per curiam ruling by the Eighth Circuit Court of Appeals. *Coonley v. Fortis Benefit & Ins. Co.*, 128 F.3d 675 (8th Cir. 1997) (per curiam).

160. 102 F.3d 1435 (7th Cir. 1996).

161. *Id.* at 1440. In addition benefits were deemed to have been properly denied since they were available only for employees, and the finding that the claimants did not fit this category was not arbitrary or capricious.

162. *Id.* at 1437. The plan administrators were aided by the fact that the plan documents conferred discretion upon them to interpret eligibility criteria, and this meant that their decision was reviewable under an arbitrary and capricious standard rather than de novo. *See id.* at 1438.

163. *E.g.*, *Capital Cities/ABC, Inc. v. Ratcliff*, 141 F.3d 1405, 1412 (10th Cir. 1998) (emphasizing “the fact that the Carriers had signed the Agreements, which specifically provided that they would receive no benefits”); *Clark v. E.I. DuPont de Nemours & Co.*, No. 95-2825, 1997 WL 6958, at *2 (4th Cir. Jan. 9, 1997) (noting that plan participants are those who “according to the language of the plan itself, [are] eligible to receive a benefit under the plan”); *Trombetta*, 102 F.3d at 1437, 1440 (noting that benefit plan participation was limited to employees and the bank loan originators had executed independent contractor agreements which acknowledged that they were not employees); *Abraham v. Exxon Corp.*, 85 F.3d 1126, 1131 (5th Cir. 1996) (upholding administrator’s construction of the plan to exclude leased employees).

illustrated by the rulings in *Microsoft*.¹⁶⁴ Even though the company had limited benefit eligibility to common law employees, that classification incorporated the freelance contract workers Microsoft did not want to include. Microsoft was then forced to rely on its interpretation of the plan language that tied benefit eligibility to workers who were on the company's U.S. payroll. Unfortunately for Microsoft, the Ninth Circuit panel found the plaintiffs' view that eligibility included payment through accounts receivable as well as through Microsoft's payroll department, a permissible construction of Microsoft's plan eligibility requirements.¹⁶⁵ However, the en banc decision held that the benefits plan administrator must initially determine the actual plan construction.¹⁶⁶

To avoid this type of problem, particularly with respect to contingent employees, the benefit plans in *Clark* and *Abraham* incorporated specific eligibility exclusions. The plan documents stated explicitly that leased employees were not covered. Since the plaintiffs in both cases were clearly within that category, they could not rely upon contract principles to support their claims. The very same result was applied to the plaintiffs in *Coonley* and *Capital Cities/ABC, Inc.* In *Coonley*, the court made an explicit finding that the insurance policy claimant was not an employee under common law standards, and therefore was not eligible for life insurance benefits.¹⁶⁷ The *Capital Cities/ABC, Inc.* court reached the same result, but emphasized the newspaper carriers' agreement not to be eligible for benefits along with the eligibility criteria contained in the governing plan documents.¹⁶⁸ Finally, the *Trombetta* court found support for the denial of benefits to the plaintiffs in the factual conclusion that the claimants were not common law employees, as well as their admission of independent contractor status on the employment contracts they signed.¹⁶⁹

To successfully resist contingent employee benefit claims on contract-based principles, it is necessary for the governing plan document to be as clear and precise as possible in defining eligible participants as well as those who are excluded. It is true that as a result of the complexity of Microsoft's employment structure, the Ninth Circuit panel was able to find that Microsoft intended to

164. See notes 79-123 and accompanying text.

165. *Microsoft Corp. I*, 97 F.3d 1187, 1196 (9th Cir. 1996).

166. *Microsoft Corp. II*, 120 F.3d 1006, 1014 (9th Cir. 1997) (en banc). In contrast, the panel ruling as well as seven members of the en banc court concluded that the determination could be made by the court directly because Microsoft's argument had not been presented to the plan administrator when the freelancers' claim was first heard. Compare *Microsoft Corp. II*, 120 F.3d 1006 (9th Cir. 1997) (en banc), with *id.* at 1015 (Fletcher, J., concurring in part, dissenting in part) and *Microsoft Corp. I*, 97 F.3d 1187 (9th Cir. 1996). Had the plan document explicitly stated that only workers who received their compensation from the payroll department were eligible for benefits, the analysis of both the panel and en banc opinions likely would have resulted in a Microsoft victory.

167. 956 F. Supp. 841, 858-60 (N.D. Iowa), *aff'd*, 128 F.3d 675 (8th Cir. 1997) (per curiam).

168. *Capital Cities/ABC, Inc. v. Ratcliff*, 141 F.3d 1405, 1412 (10th Cir. 1998).

169. *Trombetta v. Cragin Fed. Bank for Sav. Employee Stock Ownership Plan*, 102 F.3d 1435, 1439-40 (7th Cir. 1996).

include all common law employees paid from U.S. sources. This intent overrode an apparently conflicting intent reflected in the documents signed by the employees upon hiring.¹⁷⁰ But as the Ninth Circuit panel recognized, more careful drafting could have achieved the very result Microsoft intended.¹⁷¹ More specifically, if Microsoft had chosen to employ a leased work force and had amended the plan document to exclude leased workers, it could very well have been as successful as DuPont and Exxon in resisting benefit claims by contingent employees.¹⁷²

Nevertheless, the *Microsoft* ruling also illustrates that, in some circumstances, achieving the desired result of excluding contingent employees may produce other difficulties. In the portion of the opinion dealing with the Microsoft stock option plan, the court noted that the plan itself included an objective of obtaining tax qualified status which, in turn, obligated the company to include all employees.¹⁷³ Redrafting the plan document could enable Microsoft to exclude the freelancers from the stock option plan. However, this might not be an entirely satisfactory result. If Microsoft was successful in excluding the workers in question, it might find itself in more trouble due to the risk of losing the tax qualified status of its plan. This, in turn, could mean the loss of tax deductibility for company contributions and earnings, coupled with the immediate taxability of benefits to the employees upon their receipt of stock options.¹⁷⁴ It is likely that such benefits would not be offered without a tax

170. The panel observed that there was no evidence to suggest that the company had ever denied benefits to anyone whom it understood to be a common law employee. *Microsoft Corp. I*, 97 F.3d at 1195. The en banc opinion emphasized this point, viewing the independent contractor agreements as a reflection of the freelancer's mistaken belief that they were not common law employees. As a result, the agreements were recast by the court as mere warnings concerning the benefit implications if the freelancers were independent contractors. *Microsoft Corp. II*, 120 F.3d at 1011-12.

171. *Microsoft Corp. I*, 97 F.3d at 1196. The en banc opinion did not address this question because it remanded the issue of the claimants' benefit eligibility back to the plan administrator, but nothing in the opinion suggests any disagreement with the panel position on this point.

172. In fact, Microsoft took steps to avoid future benefit eligibility problems. As explained in the panel ruling, the company converted its freelancers by giving them "the option of terminating their employment relationship with Microsoft completely or continuing to work at the company but in the capacity of employees of a new temporary employment agency, which would provide payroll services, withhold federal taxes, and pay the employer's portion of FICA taxes." *Id.* at 1191. On remand, the district court held that the plaintiff group included all the converted workers who met the standard for classification as a Microsoft common law employee. *Vizcaino v. Microsoft Corp.*, 1998 Daily Lab. Rep. (BNA) No. 138, at E11 (July 20, 1998). Even if these individuals are successful in the litigation, however, the precedent would not apply to other benefit plans which specifically exclude leased workers.

173. *Microsoft Corp. I*, 97 F.3d at 1197; *Microsoft Corp. II*, 120 F.3d at 1014-15.

174. Depending upon the type of benefit plan at issue, tax advantages can include tax deferral on the benefit until received by the beneficiary (a major consideration in deferred salary plans), I.R.C. § 402 (1994 & Supp. II 1996), amended by I.R.C. § 402 (West Supp. 1998);

preference. The tax code requires that particular individuals must be included in a benefit plan in order to receive favorable tax treatment as a way of pressuring the employer toward mandatory benefit program participation, albeit in an indirect fashion.¹⁷⁵ However, while most court decisions see the tax code as simply regulating the tax consequences of the employer's benefit plan without creating a specific obligation to afford benefits to members of the non-permanent work force, some have taken a contrary approach.

In *Renda v. Adam Meldrum & Anderson Co.*,¹⁷⁶ the pension benefit claimant had spent many years working for a jeweler that had leased space from a department store to operate a jewelry sales and repair business. In securing her job, however, the claimant not only dealt with the operator of the jewelry franchise, but also with representatives of the department store's personnel office. In particular, she filled out an employment application from the department store, attended its orientation, wore its name tags for approximately twenty-eight years, and received various tokens of acknowledgment for her department store service.¹⁷⁷ The claimant also received her paychecks through the department store's payroll system for most of her employment period, although toward the end of her career, she received checks issued from the jeweler's account.¹⁷⁸

The department store had established its pension plan in 1976. The plan provided that an "associated employer had the option of adopting the plan on behalf of employees working in that associated employer's department."¹⁷⁹ The claimant's employer, however, declined to participate in the plan. Not surprisingly, the claimant never received a summary plan description nor was she ever notified that she was a participant in the pension program.¹⁸⁰ Nevertheless, when the claimant retired she sought benefits under the plan. The employer's Retirement Committee considered her claim, but ultimately determined that she was ineligible.¹⁸¹

In reviewing the claim, the district court recognized the relevance of a number of legal principles. These included: 1) the ERISA doctrine that whether

immediate deductibility of the benefit contribution by the employer, *id.* § 404; and tax deferment on the investment earnings of the plan, *id.* § 501.

175. This is most directly illustrated by the rules that bar employers from discriminating in favor of highly-compensated employees in the construction of their pension plans. To the extent employers feel the competitive necessity of offering such plans to their executives, they are pressured into offering non-highly compensated individuals participation rights as well. The provisions barring top-heavy pension plans from securing favorable tax treatment are contained in I.R.C. §§ 401(a)(4); 410(b); 414(q)(i) (1994 & Supp. II 1996), *as amended by* Taxpayer Relief Act of 1997, Pub. L. No. 105-134, 111 Stat. 788-1103.

176. 806 F. Supp. 1071 (W.D.N.Y. 1992).

177. *See id.* at 1074-75.

178. *See id.* at 1074.

179. *Id.* at 1075.

180. *See id.*

181. *See id.*

an individual is an employee is governed by common law agency rules,¹⁸² 2) the Internal Revenue Code's pension plan requirement that leased employees are to be counted as employees of the recipient where they provide services pursuant to a leasing agreement on a substantially full-time basis for at least one year, and where the services are of a type historically performed by employees in the recipient's business field,¹⁸³ 3) another Internal Revenue Code provision authorizing regulations to "prevent avoidance of any employee benefit requirement" listed in identified sections of the Internal Revenue Code through the use of employee leasing arrangements,¹⁸⁴ and 4) the doctrine that minimum participation, vesting and funding requirements for pensions under the Internal Revenue Code also apply to ERISA.¹⁸⁵

The factual circumstances surrounding the claimant's employment status led the court to conclude that she was a common law employee of the department store.¹⁸⁶ Then it evaluated the legal significance of that finding. In so doing, the court emphasized the relevance of ERISA's requirement that pension plans may not

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

(i) the date on which the employee attains the age of 21; or

(ii) the date on which he completes one year of service.¹⁸⁷

In the court's judgment, this language "effectively prohibit[ed] participation requirements which discriminate against certain employees such as leased employees,"¹⁸⁸ and specifically applied to pension plans, even though it was inapplicable to welfare benefit plans for which there are no minimum participation, funding or vesting requirements.¹⁸⁹ The court also observed that ERISA's minimum standards for plan participation call for eligibility for

182. *Id.* at 1077. The Supreme Court has ruled that in the absence of a more specific definition, use of the term "employee" in legislation refers to common law agency principles. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322-23 (1992).

183. *Renda*, 806 F. Supp. at 1078 (citing I.R.C. § 414(n)(2) (1994 & Supp. II 1996)). The historical test has since been replaced by a requirement that the individual's work must be under the primary direction and control of the employer before he can be considered a leased employee. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1454(a), 110 Stat. 1755 (codified at I.R.C. § 414(n)(2)(C) (1994 & Supp. II 1996)).

184. *Renda*, 806 F. Supp. at 1078 n.5 (citing I.R.C. § 414(o) (1994)).

185. *Id.* at 1078.

186. *Id.* at 1079.

187. 29 U.S.C. § 1052(a)(1)(A) (1994).

188. *Renda*, 806 F. Supp. at 1081.

189. *Id.* In support of this principle, the court cited *Crouch v. Mo-Kan Iron Workers Welfare Fund*, 740 F.2d 805, 808 (10th Cir. 1984), where a union employee was held to be a participant in the union's pension program even though she was excludable from its welfare benefit plan.

employees after one year of service, normally encompassing 1000 hours of employment in a twelve-month period.¹⁹⁰ The court stated that relevant Treasury Department regulations are applicable to ERISA “not only for the purpose of determining the plan’s tax status, but also as persuasive authority in determining the rights of an employee to participation in an employee benefit plan.”¹⁹¹

Having concluded that the claimant was a common law employee of the department store, the *Renda* court found that she had met the minimum participation requirements of ERISA and was entitled to pension benefits.¹⁹² Inclusion was mandated by statute even though the claimant had never been treated as a plan participant in the pension program, and despite the fact that no contributions had been made on her behalf. In so ruling, the court rejected the view that the role of the relevant statutes was simply to determine the tax qualified status of the plan.¹⁹³ Instead, the court found that the legislation created participation rights, and therefore, the jewelry employer’s decision not to adopt the department store plan could not deprive the claimant of the option to claim pension benefits.¹⁹⁴ While she might have been able to voluntarily decline to participate in the pension program, she was never given that choice and thus no waiver theory was applicable.¹⁹⁵

The *Renda* decision was followed by a Colorado federal district court in *Bronk v. Mountain States Telephone & Telegraph, Inc.*,¹⁹⁶ although its ruling was subsequently reversed by the Tenth Circuit Court of Appeals.¹⁹⁷ In *Bronk*, the plaintiffs were leased employees who sought pension and welfare benefit plan coverage. Although the relevant plan documents indicated that coverage was only available for regular employees, the plaintiffs maintained that discrimination against individuals in their category was barred. In ruling on the claim, the district court found that the controlling issue was not “whether the administrator properly applied the terms of the plan; rather, it [was] whether, as a matter of law, the administrator was required to include [the p]laintiffs within the coverage provisions of the Plans.”¹⁹⁸ Since welfare benefit plans do not have minimum

190. *Renda*, 806 F. Supp. at 1081 (citing *Fernandez v. Brock*, 840 F.2d 622, 625 (9th Cir. 1988) (relying upon 29 U.S.C. § 1052(a)(3)(A) (1994))).

191. *Id.* at 1082.

192. This included a finding that she had worked a sufficient number of hours for the required number of weeks. *Id.* at 1079-80.

193. *Id.* at 1082.

194. *Id.* at 1083. Much of the court’s analysis of the effect of ERISA and the Internal Revenue Code is arguably dicta. Because the claimant was determined to be a common law employee, she had been erroneously excluded from the right to participate under the plan’s own terms. See D. Ward Kallstrom & Gregory D. Wellons, *Benefit Eligibility of “Contingent” Workers: Pitfalls for Employers and Administrators*, 9 BENEFITS L.J. 5, 19-20 (1996).

195. *Renda*, 806 F. Supp. at 1083.

196. 943 F. Supp. 1317 (D. Colo. 1996) [hereinafter *Bronk I*], *rev’d*, 140 F.3d 1335 (10th Cir. 1998) [hereinafter *Bronk II*].

197. *Bronk II*, 140 F.3d 1335 (10th Cir. 1998).

198. *Bronk I*, 943 F. Supp. at 1322.

participation, vesting, or funding requirements under ERISA, the court recognized that no claim for discriminatory exclusion from welfare benefit plan participation could be made.¹⁹⁹ However, the court concluded that the contrary was true for pension plans.²⁰⁰

The court specifically declined to follow the rationale of the *Abraham* and *Microsoft* rulings, which limited the role of ERISA and Internal Revenue Code provisions to determining the tax qualified status of benefit programs.²⁰¹ Following the *Renda* analysis, the court held that minimum participation, vesting, and funding requirements for pension programs are obligatory on plan administrators despite the language contained in the plan, and that the standards require the inclusion of leased workers who meet the definition of common law employees.²⁰² For the district court, ERISA barred discrimination against such individuals in pension plans, in addition to barring discrimination on the basis of age or length of service as long as statutory minimums were met.

A 1984 ruling of the Tenth Circuit Court of Appeals in *Crouch v. Mo-Kan Iron Workers Welfare Fund*²⁰³ represents an earlier example of the use of statutory principles to dictate the provision of benefits to employees who might otherwise have been excluded, although the case also incorporates contract-based analysis. *Crouch* involved a union secretary who had not been included in the union's welfare and pension benefit plans. Local union officials had concluded that she was not eligible, and therefore, they had not made any contributions on her behalf.²⁰⁴ The plan denied coverage for her since it had not received any transmissions from the local union indicating that the secretary was a participant. The court recognized that the language of the plan could be read to cover her, but noted that this was not a required reading.²⁰⁵ Furthermore, welfare benefit plans are not subject to ERISA participation, vesting, and funding requirements and, therefore, "the law permits a welfare plan to discriminate against particular

199. *Id.* at 1323.

200. *Id.*

201. *Id.* at 1325.

202. *Id.* The district court also rejected the argument that this result should be limited to plans which expressly incorporate statutory requirements. *Id.* In contrast, the Tenth Circuit Court of Appeals found the *Renda* analysis unpersuasive. *Bronk II*, 140 F.3d at 1338. It concluded that the relevant statutory language of ERISA does not bar discrimination against categories of workers even with respect to pension plans which are subject to participation, vesting and funding requirements. *Id.* The earlier decision of the Tenth Circuit in *Crouch v. Mo-Kan Iron Workers Welfare Fund*, 740 F.2d 805 (10th Cir. 1984), was deemed consistent because the relevant benefit plans at issue there stated that they were to comply with ERISA, the Internal Revenue Code, and applicable Treasury Department regulations. *Bronk II*, 140 F.3d at 1338. Absent such a provision in the benefit plan, "the tax-qualification provisions of the Code do not rewrite pension plans under ERISA § 202(a) to mandate inclusion of employees, leased or otherwise, whom the plans have permissibly excluded." *Id.* at 1339-40.

203. 740 F.2d 805 (10th Cir. 1984).

204. *See id.* at 807.

205. *Id.* at 808.

employees."²⁰⁶ The court concluded that the decision to exclude the plaintiff was not arbitrary, capricious, or contrary to the plan in light of both the ambiguity of plan eligibility language and ERISA's more limited regulation of welfare benefit plans.²⁰⁷

Despite upholding the exclusion of the plaintiff from the welfare plan, the *Crouch* court ruled that the secretary was entitled to benefits under the pension plan. The court reasoned that ERISA provides for minimum participation, vesting, and funding requirements in connection with pension plans, and no exception applied to the secretary.²⁰⁸ The court found additional support for its ruling in provisions of the Internal Revenue Code that mandate inclusion of the plaintiff in order for the pension plan to achieve tax advantaged status,²⁰⁹ as well as the requirement that the plan not violate anti-discrimination requirements by favoring highly compensated employees.²¹⁰ Up to this point, the court's reasoning appeared to require coverage of the plaintiff by the pension plan because of the obligations created by existing legislation. However, the court also observed that "the pension plan state[d] that it is to be construed to meet the requirements of the ERISA."²¹¹ Consequently, the decision can be read much like the ruling in *Microsoft* in that the plan documents incorporated federal standards, therefore it was arguably the plan itself that mandated coverage, not congressional legislation.²¹²

C. The ERISA Interference Problem

The Ninth Circuit ruling in *Inter-Modal Rail Employers Ass'n v. Atchison, Topeka & Sante Fe Railway Co.*²¹³ held that ERISA's section 510 ban against interference with the attainment of any benefit was inapplicable to non-vestable welfare benefits.²¹⁴ On appeal to the Supreme Court, however, the prevailing respondents did not defend the Ninth Circuit's holding. Instead, the respondents argued that the Ninth Circuit's ruling was not necessarily that broad, and that its

206. *Id.*

207. *Id.*

208. *Id.*

209. *Id.* at 809. The primary tax advantages are the deductibility of employer contributions when made, the non-taxability of fund earnings, and the deferral of taxation on benefits to the recipient until benefits are received. *See supra* note 174 and accompanying text.

210. *Id.* (citing I.R.C. § 401(a)(4) (1994 & Supp. II 1996)). The court also noted that the statute bans discrimination against employees under 25 who have worked for at least one year for a minimum of 1000 hours. *Id.* (citing I.R.C. § 410 (1994)).

211. *Id.* at 809.

212. The district court in *Bronk I* did not believe that this was essential to the *Crouch* result, *Bronk I*, 943 F. Supp. 1317, 1324 (D. Colo. 1996), while the Tenth Circuit found it to be a "critical fact." *Bronk II*, 140 F.3d 1335, 1338 (10th Cir. 1998).

213. 80 F.3d 348 (9th Cir. 1996), *rev'd*, 117 S. Ct. 1513 (1997).

214. Respondent's Brief at 15, *Inter-Modal Rail Employers Ass'n v. Atchison, Topeka & Sante Fe Ry. Co.*, 117 S. Ct. 1513 (1997) (No. 96-491).

decision could be read to apply to situations akin to vesting, such as “where participants are about to attain the right to claim a benefit.”²¹⁵ Even with this concession, the respondents argued that the language of section 510 could not be stretched to include claims of interference with an individual’s future entitlement to benefits, but must be read with the narrower view that the law only bars preventing a participant from reaching benefit eligibility.²¹⁶ The latter position would mean that section 510 had only limited applicability to welfare benefits once an employee had worked long enough to be included in the program because eligibility would have already been attained.

The Supreme Court ruling that non-vestable welfare benefit plans are not excluded from the anti-interference prohibition, only addressed the applicability of section 510 to welfare benefit plans.²¹⁷ The Court found it unnecessary to address the respondents’ alternative approach to the statute. However, the question of how far section 510 reaches is of enormous significance.²¹⁸ If courts interpret the reach of section 510 broadly, it would mean that companies would face significant restrictions on such restructuring techniques as outsourcing, subcontracting, or using leased employees to perform needed tasks. Where the ultimate result is that the new labor force has a benefit package less favorable

215. *Id.* at 16 n.8. This would be similar to a situation in which an employee is dismissed before rights under a pension plan vest, the prototype section 510 violation. *See* *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133 (1990). The suggested theory would thus prevent an employer from interfering with an employee reaching eligibility to file a claim for a non-vestable benefit, as well as barring employers from preventing employees from attaining the point where a vestable benefit right accrues.

216. Respondent’s Brief at 17, *Inter-Modal Rail Employees Ass’n*, 117 S. Ct. 1513 (1997) (No. 96-491). *See also* *Corum v. Farm Credit Servs.*, 628 F. Supp. 707, 718 (D. Minn. 1986) (“Where the only evidence that an employer specifically intended to violate ERISA is the employee’s lost opportunity to accrue additional benefits, the employee has not put forth sufficient evidence to defeat summary judgment.”); *Baker v. Kaiser Aluminum and Chem. Corp.*, 608 F. Supp. 1315, 1318-19 (N. D. Cal. 1984). However, a comparable argument had been rejected by the Seventh Circuit in *Kross v. Western Electric Co.*, 701 F.2d 1238 (7th Cir. 1983). There, the court found that this position was inconsistent with the broad language used by Congress in section 510, *id.* at 1242, and observed that it would create the anomalous result of affording protection to probationary workers who had not yet qualified for benefit plan participation while excluding senior employees who had. *Id.* at 1243. *See also* *Gitlitz v. Compagnie Nationale Air France*, 129 F.3d 554, 558 (11th Cir. 1997); *Seaman v. Arvida Realty Sales*, 985 F.2d 543, 546 (11th Cir. 1993) (“The validity of a § 510 claim does not hinge upon whether the benefits involved are vested but upon the purpose of the discharge.”). *See generally* Dana M. Muir, *Plant Closings and ERISA’s Noninterference Provision*, 36 B.C. L. REV. 201, 240-42 (1995).

217. This issue was remanded to the lower courts for further findings. *Inter-Modal Rail Employees Ass’n*, 117 S. Ct. at 1517.

218. One commentator described the *Inter-Modal* ruling as “not surprising,” but added that it is “sitting on top of a very large issue of tremendous significance . . . [namely] what role can the cost of providing benefits play in making decisions on the movement of jobs?” *Court Leaves Outsourcing, Benefits Issues Unsettled*, 155 Lab. Rel. Rep. (BNA) 314, 315 (July 7, 1997).

than the one provided to the replaced workers, arguably the substitution interferes with the attainment of ERISA-protected benefits by the latter group. The case law thus far, however, does not provide a clear answer to the questions surrounding the reach of section 510.

The broadest support for utilizing section 510 to restrain company actions that adversely affect employee benefits is found in *Galvalik v. Continental Can Co.*²¹⁹ There the Third Circuit was confronted with a broad "liability avoidance" scheme established by the company to minimize benefit costs in response to the company's steady business decline in the mid-1970s. As described by the court, the company "had two complimentary objectives: to identify Continental's unfunded pension liabilities so as to avoid triggering future vesting by placing employees who had not yet become eligible for break-in-service on layoff, and to retain those employees whose benefits had already vested."²²⁰ Furthermore, "plant managers were authorized to shift business to plants that either had low unfunded pension liability or plants that needed the work in order to retain employees with vested 70/75 benefits."²²¹

In considering the applicability of section 510 to the Continental program, the court noted that interference with pension rights need not be the sole reason for an adverse employee action. However, the plaintiff must still demonstrate that the employer had the specific intent to violate ERISA, supported by evidence beyond the mere fact that benefits were lost as a result of employee terminations.²²² Meeting this burden would require the plaintiff to demonstrate prohibited employer conduct taken for the purpose of interfering with the attainment of ERISA rights, with the burden then shifting to the employer to demonstrate a legitimate, non-discriminatory reason for its actions.²²³ The plaintiff could then demonstrate that the proffered reason was pretextual or not credible.²²⁴

219. 812 F.2d 834 (3d Cir. 1987).

220. *Id.* at 840.

221. *Id.* The 70/75 pension was a system that allowed certain employees to qualify for pension benefits before reaching the age of 62 if (1) the employee had at least 15 years of continuous service, was 50 years or older, and had combined age and service greater than 70 years, or (2) with 15 years of continuous service, the employee's combined age and service equaled 75 or more, regardless of the individual's age. *See id.* at 838-39.

222. *See id.* at 851. In support of these principles, the court cited *Titsch v. Reliance Group, Inc.*, 548 F. Supp. 983 (S.D.N.Y. 1982), *aff'd*, 742 F.2d 1441 (2d Cir. 1983), and *Watkinson v. Great Atl. & Pac. Tea Co.*, 585 F. Supp. 879, 883 (E.D. Pa. 1984). The specific intent requirement has been described as a mechanism for balancing "the need to protect the employment relationship with the preservation of employers' general rights to control their employment decisions and to operate in an efficient and profitable manner." Dana M. Muir, *ERISA Remedies: Chimera or Congressional Compromise?*, 81 IOWA L. REV. 1, 7 (1995).

223. *See Galvalik*, 812 F.2d at 853.

224. *See id.* The allocation of burdens of proof followed the pattern established for Title VII in *McDonald Douglas Corp. v. Green*, 411 U.S. 792 (1973), and *Texas Dep't of Community Affairs v. Burdine*, 450 U.S. 248 (1981). *See id.* at 852. *See generally* Christina A. Smith, *The Road to*

Applying the applicable burden of proof standard, the *Galvalik* court concluded that the factual findings of the district court established the existence of a section 510 violation. From the court's perspective, "if Continental's liability avoidance scheme [did] not constitute direct proof of discrimination under section 510, we are hard pressed to imagine a set of facts that would."²²⁵ Therefore, the appellate court reversed the denial of relief by the district court. The court found that section 510 is applicable where it is shown that there were "deliberate steps undertaken for the purpose of interfering with the appellants' attainment of pension eligibility,"²²⁶ even in the absence of a showing of an actual deprivation of rights. The case was ultimately remanded to the district court with directions that it determine the eligibility of various plaintiffs for damages, while at the same time affording the employer the opportunity to prove that the affected employees, individually or as a group, would have been treated the same way even in the absence of the liability avoidance program.²²⁷

In a somewhat similar fashion, "smoking-gun" evidence established a section 510 violation in *Pickering v. USX Corp.*²²⁸ Under the operative collective bargaining agreement between the company and the United Steel Workers of America, laid-off employees continued to accumulate service for pension purposes for two years, and the two-year period renewed if the laid-off employee was recalled. Managers were therefore encouraged to avoid recalling workers on layoff status in order to prevent them from becoming re-entitled to benefits that would have otherwise expired.²²⁹ There was also a dramatic increase in plant overtime and subcontracting during the same period.²³⁰ The court found this evidence sufficient to establish a prima facie case that the company avoided recalling laid-off employees for the specific purpose of minimizing future pension liability.²³¹ The company sought to negate the inference of discrimination by pointing to the depressed condition of the steel industry, the cumbersome and inefficient character of the recall process, and the fact that seniority requirements were not violated.²³² Nevertheless, the court ultimately concluded that the stated reasons were pretextual.²³³

A more recent decision from the Eleventh Circuit Court of Appeals, *Gitlitz*

Retirement—Paved with Good Intentions but Dotted with Potholes of Untold Liability: ERISA Section 510, Mixed Motives and Title VII, 81 MINN. L. REV. 735 (1997).

225. *Galvalik*, 812 F.2d at 856.

226. *Id.*

227. *Id.* at 865-66.

228. 809 F. Supp. 1501 (D. Utah 1992).

229. *See id.* at 1534-35.

230. *See id.* at 1534. The logical inference from this fact was that overtime and subcontracting were used to avoid recalling laid-off employees. *See id.* at 1537.

231. *Id.* at 1536-37.

232. *See id.* at 1537-38.

233. *Id.* at 1550-51. In addition, the court found that company's separate decision to idle its plant following a work stoppage also violated section 510 on the basis of evidence that the idle decision was made for the purpose of avoiding pension obligations. *Id.* at 1551-52.

v. Compagnie Nationale Air France,²³⁴ illustrates the potential applicability of section 510 to an employer's conversion of his work force from an employer/employee to an independent contractor relationship. The suit was filed by two outside sales employees of Air France who were converted to independent contractor status. Both employees were eligible for early retirement benefits at the time of the conversion, but were informed that they could not receive them if they continued to work for Air France as independent contractors, and that they would not accrue additional retirement benefits following the change in their status.²³⁵ The plaintiffs produced evidence that there was no change in the job functions the sales representatives performed as independent contractors. The only justification the company offered for the conversion was its desire to improve work force motivation.²³⁶ The court concluded that the evidence was sufficient to demonstrate a specific intent to interfere with ERISA rights and thus survive a motion to dismiss.²³⁷ The court based its conclusion on the fact that the only feature of the company's new independent contractor arrangement linked to the improvement of worker motivation was a bonus method of compensation which could have easily have been incorporated into the discontinued employer/employee system.²³⁸

Decisions from other jurisdictions, however, have been less supportive of employee section 510 claims. For example, in *Andes v. Ford Motor Co.*,²³⁹ the claimants sought to rely on section 510 to challenge their loss of benefits following a decision by the Ford Motor Company to sell its Dealer Computer Services subsidiary. It was clear that the employees, after transfer to the purchaser, received reduced benefits. However, Ford was able to establish a legitimate reason for selling off the unit since it was not a core function, and at the time, the company had been experiencing serious economic losses.²⁴⁰ Its argument that company resources could be spent more effectively on other activities was sufficient to rebut the plaintiffs' claim.²⁴¹ Of particular significance was the court's observation that in organizational change cases, "the courts of appeals have thought it inappropriate to afford plaintiffs a full trial in order to determine how much of a company's motivation can be attributed to a desire to avoid benefit costs."²⁴² In contrast, courts have been reluctant to grant employers summary judgment in cases where individual employees have been discharged.²⁴³ In the court's view, this suggested that "a corporate organizational

234. 129 F.3d 554 (11th Cir. 1997).

235. *See id.* at 556-59.

236. *See id.* at 559.

237. *Id.* at 560.

238. *Id.*

239. 70 F.3d 1332 (D.C. Cir. 1995). *See generally* Andre P. Barlow, *Loss of Retirement Benefits After Corporate Sale Does Not Violate ERISA*, 65 GEO. WASH. L. REV. 764 (1997).

240. *See Andes*, 70 F.3d at 1333.

241. *See id.*

242. *Id.* at 1337.

243. *See id.* However, a court will dismiss a section 510 complaint where there is no

change that results in the termination of employees is really not a prototype of the sort of action that section 510 was primarily designed to cover."²⁴⁴

In a similar fashion, the plaintiffs in *Nemeth v. Clark Equipment Co.*²⁴⁵ were unable to establish a section 510 violation when the company closed the plant where they worked and shifted production to another facility. This step had been taken by the company after sharp losses raised the distinct possibility of bankruptcy, leading the company to conclude that it needed to reduce production capacity and overhead costs.²⁴⁶ Plaintiffs were able to establish that defeating pension eligibility was a significant factor in the company's decision because pension costs amounted to slightly more than one-fifth of the operating cost differences between the plant closed and the plant retained.²⁴⁷ The court rejected the company's defense that its action could be justified because of the legitimate motivation of halting mounting economic losses on the grounds that this would defeat the purpose of section 510.²⁴⁸ Nevertheless, the evidence established that pension considerations were only one of many factors, and "no single factor standing alone motivated or dominated" the plant closure decision.²⁴⁹ As in *Andes*, the court rejected the notion that section 510 is only applicable in cases of individual termination decisions as opposed to more generalized corporate policy actions.²⁵⁰ The court found that the plaintiffs' section 510 claim could not be sustained, however, concluding that the company would have reached the same closure decision "even if it had ignored the cost of the pension plan altogether."²⁵¹

Looking at existing court decisions, a pattern emerges in section 510 cases involving claims of interference with employees' attainment of ERISA benefit rights. The employer's actions have usually been immune from attack where the loss of benefits is attributable to corporate organizational changes that appear to have multiple justifications.²⁵² This has been true in decisions from the Third,²⁵³

evidence of an employer intent to interfere with benefit rights, even if the plaintiff has suffered a loss of benefits in fact. See *DeVoll v. Burdick Painting, Inc.*, 35 F.3d 408, 410-11 (9th Cir. 1994).

244. *Andes*, 70 F.3d at 1337. The court recognized that there may be situations where § 510 is applicable to organizational changes, for example where the company closes a unit because a very high proportion of its employees are at the verge of becoming eligible for significant benefits. *Id.* at 1338.

245. 677 F. Supp. 899 (W.D. Mich. 1987).

246. See *id.* at 902.

247. See *id.* at 904.

248. *Id.* at 905.

249. *Id.* at 906.

250. *Id.* at 906-07.

251. *Id.* at 909.

252. Employers have argued that ERISA is not applicable to structural changes which affect the benefit status of the work force, but the response has generally been that "ERISA does not distinguish between the termination of one employee and the termination of 100 employees. Either action is illegal if taken with the purpose of avoiding pension liability." *Id.* at 907. The arguments in favor of the applicability of ERISA in such circumstances are explored in Muir, *supra* note 222,

Fifth²⁵⁴ and Eleventh²⁵⁵ Circuit Courts of Appeals. Additionally, employers are free to modify or terminate the plans even though this may adversely affect benefit levels for employees.²⁵⁶ In contrast, individual termination decisions are likely to be more carefully scrutinized.²⁵⁷ However, this does not necessarily mean that section 510 will unduly restrain the employer from taking the contemplated action.

III. LEGISLATIVE AND PRIVATE SECTOR ALTERNATIVES

There is little reason to doubt that contingent employment has become both a significant and permanent part of the American labor market. Employers have found that such work arrangements meet their business needs, and often do so at

at 223-40.

253. See *Pension Benefit Guar. Corp. v. White Consol. Indus., Inc.*, 998 F.2d 1192 (3d Cir. 1993), *cert. denied*, 510 U.S. 1042 (1994) (no section 510 complaint stated where the company sold unprofitable subsidiaries and their associated underfunded pension plans since employee/participants maintained their participation after the transaction).

254. See *Unida v. Levi Strauss & Co.*, 986 F.2d 970 (5th Cir. 1993) (no ERISA violation in plant closing due to decrease in demand for company product even though nearly four hundred workers lost the opportunity to have their pensions vest and a plant in the Caribbean operated under a program to encourage investment in certain countries remained open).

255. See *Daughtrey v. Honeywell, Inc.*, 3 F.3d 1488 (11th Cir. 1993) (general motivation to reduce operating costs insufficient for section 510 claim); see also *Phillips v. Amoco Oil Co.*, 799 F.2d 1464 (11th Cir. 1986), *cert. denied*, 481 U.S. 1016 (1987) (no section 510 claims stated in the context of the sale of an entire business).

256. See *DeVoll v. Burdick Painting, Inc.*, 35 F.3d 408 (9th Cir. 1994), *cert. denied*, 514 U.S. 1027 (1995) (finding that an employer committed no violation in decision to change employee medical plan; this does not constitute interference with an employee's use of benefits); *Izzarelli v. Rexene Prods. Co.*, 24 F.3d 1506 (5th Cir. 1994) (finding that employer does not violate fiduciary standards in acting to terminate, amend, or renegotiate non-vested benefit plan); *McGann v. H & H Music Co.*, 946 F.2d 401 (5th Cir. 1991), *cert. denied*, *Greenberg v. H & H Music Co.*, 506 U.S. 981 (1992) (finding no ERISA violation in reduction of benefits under health plan for HIV claimants); *Reichelt v. Emhart Corp.*, 921 F.2d 425 (2d Cir. 1990), *cert. denied*, 501 U.S. 1231 (1991) (finding no ERISA violation committed by employer who amended severance plan in the context of a business sale).

257. In *Seaman v. Arvida Realty Sales*, 985 F.2d 543 (11th Cir. 1993), for example, real estate sales persons were required to execute independent contractor agreements to continue working for the company so that the employer would no longer have to contribute to the retirement and health insurance programs on their behalf. *Id.* at 544. The decision did not reveal any corporate organizational change. Although this was held a section 510 violation, the court emphasized that the company was not barred by the ruling from either modifying or eliminating the plans entirely. *Id.* at 546-47. In a similar fashion, the court in *Gitlitz v. Compagnie Nationale Air France*, 129 F.3d 554 (11th Cir. 1997), held that section 510 was applicable to the conversion of outside sales representatives to independent contractor status for the purported objective of improving worker motivation. *Id.* at 559-60.

a lower cost than that associated with traditional permanent employees.²⁵⁸ In part, this is due to the employer's ability to create an exclusively contingent work force, or implement a two-tier employment system, with those in the contingent employment category excluded from participation in benefit programs available to the permanent work force.²⁵⁹ The only risk employers face in pursuing such a structure is if their benefit plans do not clearly exclude contingent employees, as in *Microsoft*,²⁶⁰ or where the employer seeks to convert his permanent work force into a contingent one for the specific purpose of interfering with the employees' workplace benefits, as in *Inter-Modal*.²⁶¹

Employers, of course, are subject to labor market constraints in their efforts to create exclusively contingent or two-tier employment structures. Particularly in a vibrant economy with labor market shortages, it may prove necessary to provide benefits to all employees in order to attract needed workers. This can be accomplished either by directly offering benefits to contingent employees, or paying the extra cost of securing workers through staffing agencies which provide these benefits. Nevertheless, this does not occur in all situations,²⁶² and

258. Part of the reason is the generally lower wage contingent employees receive. See Belous, *supra* note 35, at 873-75; Jonathan P. Hiatt & Lynn Rhinehart, *The Growing Contingent Workforce: A Challenge for the Future*, 1993 Daily Lab. Rep. (BNA) No. 154, at d23 (Aug. 12, 1993). Also important is the fact that contingent workers are less likely to receive workplace benefits. See *supra* note 10. Additionally, the use of a contingent work force may allow the employer to shift training expenses to the employee or to the firm providing the leased or temporary help. See *Growth of Contingent Workforce Posing Policy Questions; Benefit Equities Debated*, 1988 Daily Lab. Rep. (BNA) No. 98, at A11 (May 20, 1988).

259. See *supra* note 10.

260. *Microsoft Corp. I*, 97 F.3d 1187 (9th Cir. 1996), *aff'd on reh'g*, *Microsoft Corp. II*, 120 F.3d 1006 (9th Cir. 1997) (en banc), *cert. denied*, 118 S. Ct. 899 (1998). It remains to be seen whether the Time Warner benefit plan and employee classification structure recently challenged by the U.S. Department of Labor contains the same flaw as the Microsoft system. See Schlesinger & Shapiro, *supra* note 15.

261. *Inter-Modal Rail Employees Ass'n v. Atchison, Topeka & Santa Fe Ry.*, 117 S. Ct. 1513 (1997). Nothing in *Inter-Modal*, or in other cases decided pursuant to section 510 of ERISA, necessarily suggests that there are any restraints on the creation of new contingent employment relationships in which benefits are not provided, as opposed to situations, in which existing employees with benefits are converted to contingent employees without benefits. Nevertheless, arguably the purposeful creation of positions designed to avoid benefit eligibility may constitute a section 510 violation. See Gwen Thayer Handelman, *On Our Own: Strategies for Securing Health and Retirement Benefits in Contingent Employment*, 52 WASH & LEE L. REV. 815, 833-34 (1995).

262.

Agencies that lease contingent workers to other companies do sometimes provide their workforce with certain employee benefits (especially group life and health insurance), but this practice is most commonly found in the case of executive, professional, and other highly skilled workers, and the workers often pay a substantial portion of the cost of the coverage.

the issue of contingent employee exclusion from benefit program eligibility remains a significant public policy question.

One possible solution to this problem entails imposing a general legal obligation on employers to provide specific benefits to all workers, including contingent employees. However, there is no realistic prospect that any such legislation will be enacted in the foreseeable future, even though this would ensure worker benefit coverage. The controversy generated by the health care proposals of President Clinton during his first administration demonstrates that there is significant resistance to mandating even as critical a benefit as health insurance,²⁶³ but this is merely an illustration of the more general reluctance of Congress to interfere with the virtually complete freedom of choice employers now have in deciding whether to make any workplace benefits available. Nor is there any sign that the states are prepared to fill the gap by creating new employer obligations because to do so would create a competitive disadvantage with neighboring states in the effort to lure businesses to relocate.

ERISA²⁶⁴ and the Internal Revenue Code,²⁶⁵ the legislative schemes most directly applicable to workplace benefit programs, contain few limitations on the creation of contingent employment arrangements that deny non-traditional workers benefit program rights. Both largely address themselves to benefit requirements with respect to traditional employees, and have little to say about any duties employers might have to provide benefits to contingent workers. Where contingent employment is recognized, employers are generally given unrestricted discretion in deciding whether or not to include contingent workers in their benefit plans.

Part-time workers illustrate one aspect of this issue. As long as an employer restricts his employees to a work year below the applicable legal threshold,²⁶⁶ he

Kallstrom & Wellons, *supra* note 194, at 6. See also Judy Greenwald, *Temp Agencies Offering Full-Time Benefits*, BUS. INS., Dec. 9, 1996, at 3.

263. Initially there was some optimism that the President's health care reform proposals would be adopted, although perhaps in a piecemeal fashion. See, e.g., Hammond, *supra* note 33, at 163. In the end, however, the President's proposals were defeated, and as one commentator has opined, this may have been "the catalyst . . . producing the first Republican Congress in 40 years." Albert Hunt, *Politicians Risk Voter Backlash This Autumn if They Ignore Call for Action*, WALL ST. J., June 25, 1998, at A9.

264. 29 U.S.C. §§ 1001-1461 (1994 & Supp. II 1996), as amended by Taxpayer Relief Act of 1997, Pub. L. No. 105-134, 111 Stat. 788-1103 (Aug. 5, 1997).

265. I.R.C. §§ 1-9602 (1994 & Supp. II 1996), as amended by Taxpayer Relief Act of 1997, Pub. L. No. 105-134, 111 Stat. 788-1103 (Aug. 5, 1997).

266. For purposes of ERISA, which regulates participation standards, the accrual of benefits, and the vesting of pension rights for an employer's own employees, the law focuses on whether the employee worked in excess of 1000 hours during the year. 29 U.S.C. §§ 1052 (a)(1), 1052 (a)(3)(A) (1994). See also Edward A. Lenz, *Co-Employment—A Review of Customer Liability Issues in the Staffing Services Industry*, 10 LAB. LAW. 195, 211 (1994). Pension plan participation may be limited to employees who meet this standard. See I.R.C. §§ 410 (a)(1)(A)(ii), (a)(3)(A) (1994). In contrast, where the issue is whether to count leased employees to determine the tax

is under no duty to include such part-time workers in the company's benefit system. While it is true that employers are not prohibited from allowing part-time workers to participate in company benefit programs, and many have found such a policy competitively advantageous,²⁶⁷ there is no legal requirement that they do so. Proposals to provide at least pro-rata benefit program rights to part-time workers have been unable to garner the support necessary for enactment.²⁶⁸

A second illustration is provided by the special requirements applicable to leased employees. Benefit program restrictions relating to leased workers were imposed as a result of employer efforts to avoid prohibitions against 'top-heavy' pension plans which unduly favored highly compensated employees.²⁶⁹ Some employers attempted to circumvent prohibitions against such pension programs by transferring their non-highly compensated staff to leasing agencies, and restricting pension plan participation to the highly compensated personnel who remained.²⁷⁰ In response to this abuse, Congress imposed a requirement

qualified status of a pension plan, those who work on a "substantially full-time" basis, or generally more than 1500 hours in a year, must be included in the calculation. Internal Revenue Code § 414(n)(2)(B) (Supp. II 1996) contains the statutory "substantially full-time" basis standard. Proposed IRS regulations set a figure of 1500 hours or 75% of the median hours worked by employees performing similar services for the employer, with a minimum of 501 hours. See Hammond, *supra* note 33, at 185-90. The structure of the law has therefore led employers to maintain pools of on-call workers whose hours are kept below the 1000 hour limit in order to avoid benefit obligations without jeopardizing the tax qualified status of the plan. See Francoise J. Carre, *Temporary Employment in the Eighties*, in *NEW POLICIES FOR THE PART-TIME AND CONTINGENT WORKFORCE*, 78, 78-79 (Virginia du Rivage, ed. 1992).

267. This was illustrated in United Parcel Service ("UPS") strike during the summer of 1997. UPS is a large employer of part-time workers, and as a matter of company policy it provides them with benefit program participation rights. See Nancy Ann Jeffrey, *Families of Some UPS Strikers Express Concerns About Health-Care Coverage*, WALL ST. J., Aug. 15, 1997, at A2.

268. See Part-Time and Temporary Workers Protection Act, H.R. 2118, 103d Cong., 1st Sess. (1993). This proposed legislation would have made pro-rata pension and health benefits available to all employees who worked more than 500 hours during the year. See Kenneth G. Dau-Schmidt, *The Labor Market Transformed: Adapting Labor and Employment Law to the Rise of the Contingent Work Force*, 52 WASH. & LEE L. REV. 879, 886-87 (1995) (advocating proportionate benefits for contingent workers); Patricia Schroeder, *Does the Growth in the Contingent Work Force Demand a Change in Federal Policy?*, 52 WASH. & LEE L. REV. 731, 736-37 (1995).

269. In order to secure favorable tax treatment, employer pension plans are barred by the Internal Revenue Code from discriminating in favor of "highly compensated employees." I.R.C. §§ 401(a)(4), 410(b), 414(q)(i) (1994 & Supp. II 1996), *as amended by* Taxpayer Relief Act of 1997, Pub. L. No. 105-134, 111 Stat. 788-1103 (Aug. 5, 1997).

270. Internal Revenue Code § 401(a) requires that retirement plans be maintained "for the exclusive benefit of . . . employees and their beneficiaries," *id.* § 401(a), thus barring favorable tax treatment for plans which include non-employees. See *Professional & Executive Leasing, Inc. v. Comm'r*, 862 F.2d 751 (9th Cir. 1988) (leasing agency plan which included its leased workers ineligible for favorable tax treatment because workers were employees of recipient employers). According to one commentator, the leased employee rules were prompted by a "narrow abuse"

contained in Internal Revenue Code § 414(n) that leased employees must be counted for purposes of determining whether the company's benefit program unlawfully discriminated in favor of highly compensated personnel.²⁷¹

In order to be considered a leased employee under Internal Revenue Code § 414(n), and therefore countable for purposes of determining the plan's eligibility for favorable tax treatment, the services must be performed under an agreement between the recipient employer and the leasing organization, and the worker must generally have been employed for at least 1500 hours during a one-year period.²⁷² The Small Business Job Protection Act of 1996²⁷³ added the requirement that the leased employee's work must be performed under the primary direction and control of the recipient.

If the employer is careful in his use of leased workers, the Internal Revenue Code's 'counting' requirement is likely to be of marginal significance. First, the employer can limit his use of leased workers to less than 1500 hours during the year. Alternatively, employers can utilize leasing agencies which provide supervision along with a staff of leased workers since the right of control in such an arrangement would not be vested in the employer.²⁷⁴ It is also generally true that leased professionals, such as attorneys, accountants, doctors, systems analysts, and engineers, who normally use independent judgment and discretion in performing their functions, are unlikely to be considered leased workers for purposes of determining a plan's eligibility for favored tax treatment.²⁷⁵

engaged in by certain small professional groups who were firing their entire staffs, transferring them to the payroll of a leasing organization, and then setting up rich pension plans for themselves. LENZ, *supra* note 33, at 22.

271. I.R.C. § 414(n) (1994 & Supp. II 1996).

272. Internal Revenue Code § 414(n)(2)(B) requires that companies count leased employees who work on a "substantially full-time" basis. *Id.* § 414(n)(2)(B) (Supp. II 1996). Proposed IRS regulations set a figure of 1500 hours or 75% of the median hours worked by employees performing similar services for the employer, with a minimum of 501 hours. *See* Hammond, *supra* note 33, at 185-90.

273. Pub. L. No. 104-188, § 1454(a), 110 Stat. 1755 (codified at I.R.C. § 414(n)(2)(C) (Supp. II 1996)). The 'direction and control' test replaced the previous requirement that the work be of a type historically performed by employees in the recipient's field of business. The new test narrows the applicability of the leased employee rules. *See* LENZ, *supra* note 33, at 23; Kallstrom & Wellons, *supra* note 194, at 13. According to one commentator, the prior historical performance test focused on "whether, as an industrial practice, the services being performed are those that are typically performed by persons treated as employees of the service recipient." Hammond, *supra* note 33, at 161, 184.

274. *See* LENZ, *supra* note 33, at 23 ("[C]ustomers will not have to count a third-party employee as a potential leased employee in cases where the employee's work is directed and controlled primarily by the staffing firm and not the customer."). However, the right of control test is measured by the totality of the circumstances, and retention of some supervision rights by the employer may be enough to trigger applicability of the leased employee rules.

275. This conclusion is based on the legislative history behind the new right of control test for determining leased worker status contained in the Small Business Job Protection Act of 1996,

Furthermore, workers are not treated as countable leased employees if they participate in a "safe-harbor" pension plan provided by the leasing organization,²⁷⁶ and customers receive a credit for any benefits their leased workers receive from the leasing firm.²⁷⁷ In the final analysis, the system ensures limited applicability of the leased employee restrictions contained in the Internal Revenue Code. But in any event, the predominate judicial view of these provisions is that they only serve to determine the tax qualified status of a benefit plan, and do not encompass a leased employee right of participation.²⁷⁸

Employers who do not use employee leasing agencies to create contingent employment arrangements in order to avoid benefit costs may achieve the same result through the use of independent contractors. There is a well-established principle in the common law which distinguishes between employees and independent contractors based upon the degree of control retained by the employer over the manner in which the work is performed.²⁷⁹ The distinction has become relevant for a number of employment law purposes.²⁸⁰ The relevance of the distinction for employee benefit programs is that service providers who fit within the independent contractor category will normally be deemed ineligible for participation in any plan provided by the employer for the exclusive benefit of his employees.²⁸¹

and arises from the view that such workers "regularly make use of their own judgment and discretion on matters of importance in the performance of their services and are guided by professional, legal or industry standards." *Id.*

276. See I.R.C. § 414(n)(5) (1994). The requirements are that the leasing organization must contribute at least 10% of the employee's compensation to the plan, the employee must be 100% vested in the contribution, and all employees of the leasing organization must be eligible to participate without a waiting period. See LENZ, *supra* note 33, at 2.

277. See I.R.C. § 414(n)(1)(B) (1994); LENZ, *supra* note 33, at 25-26.

278. See *supra* notes 142-72 and accompanying text.

279. The common law used the concept of an employee to govern situations in which employers could be held vicariously liable for the conduct of their workers. In contrast, vicarious liability was not imposed on anyone who hired an independent contractor to perform services. See, e.g., COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS, REPORT AND RECOMMENDATIONS 37 (1994) [hereinafter DUNLOP COMMISSION REPORT]; ROTHSTEIN & LIEBMAN, *supra* note 52, at § 2.28; Jennifer Middleton, *Contingent Workers in a Changing Economy: Endure, Adapt, or Organize?*, 22 N.Y.U. REV. L. & SOC. CHANGE 557, 576 (1996).

280. Independent contractors are excluded from coverage in the Occupational Safety and Health Act of 1970 § 3(6), 29 U.S.C. § 652(6) (1994), the National Labor Relations Act § 2(3), 29 U.S.C. § 152(3) (1994), and under state workers compensation statutes, e.g., MASS. GEN. LAWS ANN. ch. 152 § 1(4) (West 1988), and unemployment insurance codes, e.g., CAL. UNEMP. INS. CODE § 621 (West 1988).

281. If the plan is available for employees, independent contractors are, by definition, ineligible. The exclusion of non-employees is furthered under the provisions of the Internal Revenue Code that limit favorable tax treatment to those employer retirement plans which are maintained for the exclusive benefit of employees and their beneficiaries. I.R.C. § 401(a) (1994 & Supp. 1996).

Because independent contractors are not employees, employers are initially relieved of the burden of withholding employment taxes,²⁸² and paying the employer portion of Social Security²⁸³ and Unemployment Insurance²⁸⁴ for those who properly fit within the independent contractor category.²⁸⁵ The issue of how a worker should be classified, therefore, is of immediate financial significance. This determination is made by applying a twenty-factor test contained in a 1987 Revenue Ruling²⁸⁶ to evaluate the degree of control retained by the employer over the manner in which the work is performed. The test has been the subject of a published training manual designed to give guidance to both Internal Revenue Service staff and the general public on worker classification standards.²⁸⁷

282. The Internal Revenue Code contains no specific definition of an employee for purposes of withholding tax procedure. However, wages subject to withholding are defined as all remuneration “for services performed by an employee for his employer,” *id.* § 3401(a), even though the definition of an employee under the code has no content other than to include government workers and officers of corporations, *id.* § 3401(c). Nevertheless, existing case law indicates judicial reliance on the common law right of control test. *See Marvel v. United States*, 719 F.2d 1507, 1514 (10th Cir. 1983); *Lanigan Storage & Van Co. v. U.S.*, 389 F.2d 337 (6th Cir. 1968). Independent contractors must pay their tax obligations directly since they are not employees for withholding tax purposes.

283. The provisions of the Federal Insurance Contribution Act (“FICA”), I.R.C. §§ 3101-3128 (1994 & Supp. II 1996), adopt the common law rules for determining employee status. *Id.* § 3121(d)(2) (1994).

284. Pursuant to the Federal Unemployment Tax Act (“FUTA”), I.R.C. §§ 3301-3311 (1994 & Supp. II 1996), employee status is also governed by the common law right of control test. *Id.* § 3306(i) (1994).

285. In contrast, in leased employee arrangements the worker is not considered an employee if the company utilizing his services retains the right to control the manner in which he performs his work, but the responsibility for all payroll taxes falls on the leasing agency that handles the payment of wages. *See General Motors Corp. v. United States*, No. 89-CV-73046-DT, 1990 WL 259676 (E.D. Mich. Dec. 20, 1990) (mem.); Hammond, *supra* note 33, at 178-81.

286. Rev. Rul. 87-41, 1987-1 C.B. 296. The Ruling applies for classification decisions under FICA, I.R.C. §§ 3101-3128 (1994 & Supp. II 1996), and FUTA, I.R.C. §§ 3301-3311 (1994 & Supp. II 1996). The Revenue Ruling’s test for determining whether an employment relationship exists focuses on whether “the person or persons for whom the services are performed have the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished.” Rev. Rul. 87-41, 1987-1 C.B. 296. Relevant factors include whether the worker receives training and is instructed by the employer, performs the work on the employer’s premises, is paid based upon time worked rather than receiving a set fee for the job, provides his own tools, and has the opportunity for profit or loss. *Id.*

287. INTERNAL REVENUE SERV., DEP’T OF THE TREASURY, EMPLOYEE OR INDEPENDENT CONTRACTOR? (1996). A training manual proved to be necessary because the Internal Revenue Service was barred by statute from issuing any clarifying regulations or rulings on the subject of independent contractor classifications. *See Revenue Act of 1978*, Pub. L. No. 95-600, § 530(4)(b),

Business interests have persistently complained that the independent contractor standards are vague and subject to conflicting interpretations.²⁸⁸ This can result in the inadvertent misclassification of workers, which if detected in an IRS audit, may lead to substantial monetary consequences for the offending employer.²⁸⁹ However, other critics complain that employers engage in widespread employee misclassification for the explicit purpose of avoiding employment tax and benefit obligations.²⁹⁰ Where this occurs, the tax and benefit burden is unfairly shifted to the worker and the U.S. Treasury is adversely affected because of the greater difficulty experienced in collecting taxes from independent contractors.²⁹¹

Due to the potential penalties and tax assessments applicable to erroneous independent contractor classification decisions, Congress added section 530 to the Revenue Act of 1978 (the "Act").²⁹² It prohibits the IRS from penalizing misclassifications where there was a reasonable basis for the employer's belief that the independent contractor classification was correct.²⁹³ In forming a reasonable basis, the Act permits the employer to rely upon judicial precedent, prior IRS audits, or a long-recognized practice in the industry.²⁹⁴ The legislation also bars the IRS from issuing any regulations on the employment status of any worker for employment tax purposes, thus preventing the use of the administrative process to clarify worker classification uncertainties.²⁹⁵ Some

92 Stat. 2763.

288. See *Tax Issues Impacting Small Business: Hearing Before the Senate Comm. on Small Business*, 104th Cong. 47 (1995) (statement of Michael O. Roush) [hereinafter 1995 *Small Business Hearing*]. See also *id.* at 83, 85 (statement of Senator Don Nickles) (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); *id.* at 286 (statement of James C. Pyles).

289. See, e.g., *id.* at 98-99 (1995) (statement of Raymond Peter Kane) (describing penalties assessed by the IRS for misclassification); *id.* at 84 (statement of Senator Don Nickles) (observing that the "horror stories surrounding this issue are numerous and disturbing").

290. One commentator maintained that "[f]ake independent contractor scams are rampant throughout the low-wage work force sectors," including "agriculture, building services, clerical and support services, food services and catering, the garment industry, and health care." Jonathan P. Hiatt, *Policy Issues Concerning the Contingent Work Force*, 52 WASH. & LEE L. REV. 739, 749-50 (1995). See also Middleton, *supra* note 279, at 569.

291. See 1995 *Small Business Hearing*, *supra* note 288, at 261 (Coalition for Fair Worker Classification, *Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers*) (noting that there are "relatively few controls to ensure compliance" and that past IRS studies have shown that independent contractors "are more likely to underreport income and/or overstate expenses").

292. Act of 1978, Pub. L. No. 95-600, § 530, 92 Stat. 2885.

293. *Id.* § 530(a)(1)(b), 92 Stat. 2885.

294. *Id.* §§ 530(a)(2)(A)-(C), 92 Stat. 2885.

295. *Id.* § 530(b), 92 Stat. 2886. See also 1995 *Small Business Hearing*, *supra* note 288, at

changes were made to IRS enforcement procedures in the Small Business Job Protection Act of 1996, including a provision placing the burden of proof on the government where the taxpayer establishes a prima facie case that the classification decision was reasonable.²⁹⁶ However, the basic characteristics of section 530 remain intact.

At the same time, however, Congress has been considering proposals to redefine the standards for independent contractor classification decisions. The purported justification is to clarify the existing uncertainties and eliminate the unfairness of penalizing employers who in good faith, but mistakenly, treat their work force as independent contractors.²⁹⁷ However, some commentators have expressed concern that the proposals would encourage employers to reclassify common law employees to independent contractor status.²⁹⁸ The lure of avoiding employment taxes and eliminating benefit obligations²⁹⁹ might be sufficient to overcome any problems that independent contractor arrangements might otherwise entail.³⁰⁰ The reclassified employees and corresponding government

286 (1995) (statement of James C. Pyles). To circumvent this restriction, the IRS issued a training manual on worker classification standards. *See supra* note 287.

296. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1122(a), 110 Stat. 1755.

297. *See, e.g.*, 1995 *Small Business Hearing*, *supra* note 288, at 131-32 (statement of John S. Satagaj) (supporting the proposed Independent Contractor Tax Simplification Act of 1995, creating a three-part test to determine independent contractor status); *id.* at 139-41 (statement of Bennie L. Thayer). *See also Senate Bill Would Clarify Definition of Contractor*, WALL ST. J., March 14, 1996, at A14 (noting Senator Christopher Bond's concern that "[t]oo many small-business owners 'get their tutorial on the subtleties of this issue during an IRS audit'"). Independent contractor legislation was also introduced in the 105th Congress. *See, e.g.*, S. 460, 105th Cong. (1997); H.R. 771, 105th Cong. (1997).

298. *See* 1995 *Small Business Hearing*, *supra* note 288, at 287 (statement of James C. Pyles) (stating that the proposed legislation "may trigger massive reclassifications on an initial and continuing basis").

299. That lure is currently available under the existing system with its somewhat more restrictive standards for worker classification. In the words of one commentator, there are "financial incentives [which] employers enjoy for misclassifying employees through avoidance of benefit and worker compensation premiums, [as well as] a financial incentive by the tax system to engage in such unlawful misclassification." Hiatt, *supra* note 290, at 749. Loosening the classification standards would reduce the employer's risk of penalties in the event of a dispute with the IRS, thereby increasing the incentive to misclassify.

300. The financial benefits of an erroneous independent contractor classification must be weighed against "the threat of potentially ruinous assessment of taxes, interest and penalties." Gwen Thayer Handelman, *On Our Own: Strategies for Securing Health and Retirement Benefits in Contingent Employment*, 52 WASH. & LEE L. REV. 815, 836 (1995). The risk of detection from an IRS audit is part of this calculation. Additionally, however, the employer must exercise judgment in determining whether the nature of the work justifies the loss of control entailed in an independent contractor arrangement. A further concern is that contingent workers may be less qualified and loyal, as well as subject to higher turnover rates. *See* Kallstrom & Wellons, *supra*

tax collections would be adversely affected, and there would be a risk that any new IRS standard for employment tax purposes might find its way into classification decisions for other employment-related issues. The Clinton Administration criticized the proposal and raised the possibility of a veto of any legislation to ease limitations on reclassifying employees to independent contractor status.³⁰¹ While this may remove the threat for now, the idea could well resurface in the future.

Alternatively, some commentators have suggested that worker protection policies should lead to the replacement of the common law right of control test for determining independent contractor status with a more worker-oriented economic reality approach. The policy behind this alternative standard is to extend the protection available under various labor statutes to those who are functionally equivalent to traditional employees because of their comparable need for workplace protection.³⁰² The test was employed by the U.S. Supreme Court in *NLRB. v. Hearst Publications, Inc.*,³⁰³ in lieu of the common law right of control doctrine as the basis for identifying covered employees under the National Labor Relations Act ("NLRA"). More recently, the economic reality theory received support in the final report of the Dunlop Commission which recommended that:

Workers should be treated as independent contractors if they are truly independent entrepreneurs performing services for clients—*i.e.*, if they present themselves to the general public as an established business presence, have a number of clients, bear the economic risk of loss from their work, and the like. Workers who are economically dependent on the entity for whom they perform services generally should be treated as employees. Factors such as low wages, low skill levels, and having one or few employers should all militate against treatment as an independent contractor.³⁰⁴

However, to date the economic reality test has received very little legislative or judicial approval. The Supreme Court's decision in *Hearst Publications* was

note 194, at 6. However, the incentives to misclassify are often sufficient as evidenced by "[s]tudies performed by the IRS and GAO [that] have indicated that there is a significant segment of employers which may deliberately treat their employees as independent contractors." 1995 *Small Business Hearing*, *supra* note 288, at 282 (Coalition for Fair Worker Classification, *Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers*).

301. See Frank A. Aukofer, *Klecza Optimistic on Tax-Cut Legislation: Congress Starts Haggling Over Details This Week*, MILWAUKEE J. SENT., July 7, 1997; Greg Hitt, *Clinton, Republicans Fault Tax Package*, WALL ST. J., June 11, 1997, at A2.

302. See Dau-Schmidt, *supra* note 268, at 884; Hiatt, *supra* note 290, at 749-51. The lack of clear standards, however, may result in judges being able to interpret the economic realities standard to achieve virtually any result. See Middleton, *supra* note 279, at 577-78.

303. 322 U.S. 111 (1944).

304. DUNLOP COMMISSION REPORT, *supra* note 279, at 38-39.

reversed by Congress in the Taft-Hartley Act, ("Taft-Hartley")³⁰⁵ thereby returning the standard under the NLRA to the common law right of control standard in its definition of statutorily covered employees. The Supreme Court, moreover, has indicated that the definition of an employee should normally encompass the common law standard, unless there is some legislative indication that an alternative approach is required.³⁰⁶ This was found to be the case for the Fair Labor Standards Act ("FLSA"),³⁰⁷ but other labor statutes have not been treated in the same fashion. Overall, proponents of an economic reality approach to worker protection legislation, including statutes regulating workplace benefits, have very little legal support for their position.

In the final analysis, however, the most promising area for assistance to contingent employees deprived of workplace benefits may lie in affording them some of the same advantages in seeking benefits independently that employers now have. Deductibility of health insurance premiums is one example. Under current tax law, the cost of health insurance employers provide for their employees is fully deductible,³⁰⁸ and the value of the health insurance is not included as income to the employee.³⁰⁹ Until recent legislation, those classified as self-employed, in contrast, were only afforded a deductibility limit of 25% subject to yearly re-enactment of this authorization by Congress.³¹⁰ This was initially raised to 30% and made permanent,³¹¹ with deductibility limits now scheduled to increase to 100% in 2003.³¹² A better solution is to make all

305. Ch. 120, sec. 101, § 2(3), 61 Stat. 136, 137-38 (1947) (codified at 29 U.S.C. § 152(3) (1994)) (excluding coverage under the Act for those "having the status of an independent contractor").

306. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322-23 (1992); *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 740 (1989).

307. The broader definition of covered employees under the FLSA has been based upon its inclusion of language applying to those who "suffer or permit to work," a standard which "stretches the meaning of 'employee' to some parties who might not qualify under a strict application of agency law principles." *Nationwide Mut. Ins. Co.*, 503 U.S. at 326. See also *Goldberg v. Whitaker House Coop.*, 366 U.S. 28, 33 (1961); *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947).

308. The amount paid for such insurance is considered an ordinary and necessary business expense. See I.R.C. § 162(a) (1994).

309. See *id.* §§ 105(b), 106 (1994 & Supp. II 1996).

310. Eligibility for the deduction requires that the individual meet the definition of being self-employed with income from self-employment. See *id.* § 401(c)(1) (1994). This allowance was added by the Self-Employed Individuals Tax Retirement Act of 1962 (Keogh-Smathers Act), Pub. L. No. 87-792, 76 Stat. 809. The requirement of yearly re-enactment posed a risk to the self-employed who were eligible for the deduction that the benefit might be lost. See 1995 *Small Business Hearing*, *supra* note 288, at 145 (National Association for the Self-Employed, *Estimating the Number of Persons Affected by the Elimination of the 25 Percent Income Tax Deduction for Health Insurance Premiums*).

311. Business interests firmly supported the change. See 1995 *Small Business Hearing*, *supra* note 288, at 120 (statement of John P. Galles); *id.* at 136 (statement of Bennie L. Thayer).

312. The Internal Revenue Code had authorized the self-employed to deduct 45% of their

contingent employees immediately eligible to receive the same full deductibility for health insurance costs applicable to those in traditional employee relationships.³¹³ Such a policy would serve to soften the impact of the high cost of health insurance purchased separately by contingent employees excluded from employer benefit programs.³¹⁴

Tax deductibility, however, is only one of the advantages company-provided health insurance now enjoys. The other is the employer's ability to secure favorable group rates from insurance companies, an opportunity not available to individuals purchasing insurance on their own. Here, however, a solution to the problem does not necessarily require government action. As an alternative, private sector entities could negotiate on behalf of their members for favorable group insurance rates. This is available to contingent employees who belong to professional organizations that offer insurance at favorable group rates,³¹⁵ but there is an obvious gap in the marketplace for others lacking this option. Currently a private sector organization, Working Today, has been attempting to meet the insurance needs of contingent workers by offering such programs to

health insurance costs for tax years 1998 and 1999, rising to 50% in 2000, and increasing gradually to 100% in 2007. I.R.C. § 162(l)(1) (1994 & Supp. II 1996). The budget bill signed by the President in October 1998 increased the 1999 deductibility limit to 60%, with full deductibility in 2003. *See supra* note 58. Bringing forward the date for full deductibility of health insurance costs for the self-employed remains an issue in the political process, and has been considered as part of the Republican legislative proposals on Health Maintenance Organization regulation. *See* Lizette Alvarez, *After Polling, G.O.P. Offers a Patients' Bill*, N. Y. TIMES, July 16, 1998, at A1; Laurie McGinley, *Senate GOP Comes Up With a Proposal to Protect Consumers in Managed Care*, WALL ST. J., July 16, 1998, at A20.

313. One commentator maintains:

The cost of health insurance and medically necessary care should be fully deductible from taxed income for all workers. Adequate medical attention to maintain one's fitness for employment ought to be recognized as a cost that offsets earnings from labor equally as maintenance expenses on a manufacturer's capital equipment or the utility bills of a shopkeeper offset their business income.

Handelman, *supra* note 300, at 843. *See also* 1995 *Small Business Hearing*, *supra* note 288, at 120-21 (statement of John P. Galles) ("[I]t is a telling commentary on the equity of our tax law that Donald Trump can fully deduct the cost of his health care because his multi-billion dollar enterprise happens to be a corporation, yet everyday small business owners . . . can only deduct 30 percent of their health care costs."); *id.* at 136-37 (statement of Bennie L. Thayer).

314. Full deductibility would effectively reduce the cost of insurance by the taxpayers tax rate. For lower paid workers, this would mean a cost reduction of either 15% or 28%, with higher paid workers achieving greater savings. *See* I.R.C. § 1 (1994 & Supp. II 1996).

315. While organizations such as the American Bar Association may offer a wide range of insurance products at favorable group rates, this is not true in all professions. Performers, in particular, may miss out on coverage entirely if they are employed by small companies without benefit programs, and do not meet the minimum earnings figure set by the unions. *See* Milt Freudenheim, *Got the Gig, But Where's the Health Insurance?*, N. Y. TIMES, June 26, 1997, at B1.

those unable to qualify for other group coverage.³¹⁶ Although it is still in its early formative stages, Working Today is clearly pursuing the right goals at the right time.

Tax policies should also provide equivalence in the treatment of income diverted for retirement purposes. Where employees have company-provided pension plans, significant tax advantages are available. These include allowing employer contributions to be deducted immediately,³¹⁷ permitting investment assets to accumulate tax free prior to distribution,³¹⁸ and deferring the payment of taxes by the recipient until pension benefits are actually received.³¹⁹ There is no reason why a contingent worker from an employee leasing firm should not be able to benefit from the same tax inducements for retirement planning. If neither the leasing firm nor the recipient firm allow the contingent worker to participate in a pension program, with its tax deferral consequences, he should be able to do it on his own. To an extent this does occur if the individual is self-employed and establishes his own deferred compensation program,³²⁰ but not every worker fits within this category. Temporary agency employees who are paid on an hourly basis by a staffing company, for example, cannot claim the benefit of income tax deferral under the provisions applicable to retirement programs for the self-employed.³²¹ The tax laws do permit such individuals to set up IRAs, but the \$2000 per year IRA limit is well below the amount of tax deferral available to traditional employees provided with company-sponsored pension plans.³²²

316. Working Today seeks to both provide services such as group insurance to its contingent employee membership, as well as serve as a work force lobby. See Bob Herbert, *Strength in Numbers*, N. Y. TIMES, Nov. 3, 1995, at A29; Stuart Silverstein, *New Group Provides Benefits, Political Voices for U.S. Workers*, L.A. TIMES, Dec. 1, 1996, at D5. See generally *Working Today* (visited Dec. 9, 1998) <<http://www.workingtoday.org/>>. Another suggested private sector initiative would be greater union involvement in the contingent employment sector of the economy, but there are relatively few examples illustrating such an effort due to the difficulties encountered by unions in trying to organize non-traditional workers. See Middleton, *supra* note 279, at 589-99. Arguably, non-profit, private-sector buying cooperatives should be established to make available health and retirement programs to everyone, regardless of their employment status. See Cantoni, *supra* note 7, at A14.

317. See I.R.C. § 404 (1994 & Supp. II 1996).

318. See *id.* § 501.

319. See *id.* § 402.

320. Self-employed individuals became eligible for tax-favored pension plans with the passage of the Self-Employed Individuals Tax Retirement Act of 1962 which redefined the term "employee" in I.R.C. § 401(c)(1) (1994) to include the self-employed. Self-Employed Individuals Tax Retirement Act of 1962 (Keogh-Smathers Act), Pub. L. No. 87-792, 76 Stat. 809.

321. Such individuals do not meet the definition of a self-employed individual as contained in I.R.C. § 401(c) (1994), nor do they have "net earnings from self-employment" as described in I.R.C. § 1402(a) (West Supp. 1998).

322. Internal Revenue Code § 408(a)(1) (1994 & Supp. II 1996) limits IRA contributions to \$2000 per year. In comparison, benefit limits for employer-provided pension plans seeking

CONCLUSION

The forces that have produced the increasing employer utilization of contingent workers are still present in the American economy. Companies continue to desire flexibility to expand and contract their work force to meet changing production needs. They are also under increasing global competitive pressure to reduce costs. The contingent employment model is well suited to solving these problems. Therefore, it is inevitable that the contingent employment system will remain a significant component of the American labor market, with an obvious potential for growth.

Although contingent employment arrangements are likely to persist, this does not mean that the legal system must remain unresponsive to the special problems contingent employment imposes on workers within the category. Those problems, in particular, include the lack of access to employer-provided workplace benefits. Either we must rethink the existing system which permits employers to create contingent employment arrangements, or we must lessen the burden imposed on contingent employees, either by mandating benefit eligibility for them or by providing some form of assistance to those who make the effort to secure benefits on their own. Failure to do so only serves to victimize a segment of the work force especially in need of public policy protection.

One approach to the question is to leave the issue unregulated by government. This allows the employer to structure the workplace in a manner deemed most economically efficient. The marketplace will then determine whether or not contingent employees receive benefits. To a large extent, that is the current system, and it has resulted in producing an increasing number of workers without access to workplace benefits.

The opposite extreme solution would simply bar discrimination in benefit participation based upon the classification of the worker providing services. Under such a system, contingent employees of all kinds would have the benefit of equal treatment in all aspects of benefit program administration. Accommodations would very likely have to be made to account for the fact that some workers have less than full-time assignments, while others may work full-time but only on a temporary basis. Pro rata apportioning of benefits is an acceptable solution to this problem, with waivers of any benefit participation requirements in cases where the worker receives equivalent benefits elsewhere, such as from the employment agency or leasing firm which supplied him to the employer. While potentially costly, such an approach would redress the existing inequalities, but in today's political climate there is little likelihood that any such regulation could be enacted.

Even under the largely unregulated system currently employed, some restrictions exist on the employer's freedom to structure benefit programs. The leased employee restrictions, for example, impose tax consequences on

employers who create a largely contingent work force which circumvents rules against top-heavy pension plans.³²³ Additionally, section 510 of ERISA provides some protection to existing employees with benefits who are 'restructured' for the specific purpose of interfering with their benefit program participation.³²⁴ Courts may also look carefully at ambiguous benefit plan language when contingent workers are denied the right to participate in the company's benefit program.³²⁵ Finally, barring legislative change, legal standards prevent employers from misclassifying workers into the contingent category in order to avoid any obligation to pay employment taxes or allow the affected workers to participate in company-sponsored employee benefit programs.³²⁶ Nevertheless, these controls have not deterred employers from taking advantage of the wide discretion they are afforded in deciding upon benefit program eligibility.

Although directly confronting company policies that prohibit contingent employees from participating in company benefit programs is certainly one option (if not the preferred remedy) for solving the contingent employee benefits problem, alternative approaches are also available. Indeed, given the current political climate, there appears to be little prospect that Congress will take any new steps to bar companies from dealing with benefit programs largely as they see fit. Thus, it seems likely that most contingent workers will continue to be excluded from employer benefit programs, but this does not mean that legislative attention to this issue is unnecessary.

What contingent employees require at a minimum is equal access to the financial advantages available to employers who create employee benefit programs. Tax laws currently favor employers who provide benefits, while failing to recognize the increasing movement in the labor market toward self-employed and contingent workers. Secondly, contingent workers need some mechanism which would permit them to secure the same group benefit rates employers now enjoy. This is not necessarily a problem for contingent workers who have the option of joining professional organizations that already provide benefits at group rates, but those who are not in this category are in need of a private sector solutions to their problem. The efforts of organizations such as Working Today illustrate how this can be accomplished.

Even with changes of the character recommended here, contingent workers will still remain a disadvantaged component of the work force due to their insecure status. But at the very least they should not be excluded from the opportunity to participate in the kinds of workplace benefit programs that have become critical in contemporary life on terms comparable to those available to traditional employees. This would represent an important first step in restructuring the benefits system to accommodate the restructured labor market environment now characterizing the American economy.

323. See *supra* notes 269-78 and accompanying text.

324. See *supra* notes 219-57 and accompanying text.

325. See *supra* notes 79-122 and accompanying text.

326. See *supra* notes 279-301 and accompanying text.