

THE CONTRACT EMPLOYEE'S
HANDBOOK!
HELPING CONTRACT EMPLOYEES MANAGE THEIR CAREERS

Bulletin:
**Are Your Approved Staffing Agencies
Setting You Up For A Costly
Class Action Lawsuit?**

By James R. Ziegler, Ph.D.

Published by

P.A.C.E.

Professional Association of Contract Employees

www.pacepros.com

The Contract Employee's Handbook is online at

www.cehandbook.com

Bulletin:

Are Your Approved Staffing Agencies Setting You Up For A Costly Class Action Lawsuit?

Agencies With Mediocre Benefits Expose Their Clients To Great Financial Risk

Temp agencies mitigate co-employment risks

Temp agencies and recruiting firms widely advertise that they "*mitigate the risks of co-employment*". And generally speaking, they do. The IRS is less likely to reclassify contingent workers as common law employees of the client when a third-party employer of record employs those workers.

Temp agencies collect and pay payroll taxes and income taxes on behalf of their temporary employees, and in doing so they satisfy the federal and state agencies that are responsible for collecting taxes and making sure that employees are covered for federal and state entitlements.

IRS compliance is not enough

But it is foolhardy to assume that a third-party employer of record automatically confers immunity from reclassification, *especially in those situations in which agency temps believe they have been harmed by being excluded from their client's benefit plan.*

Temp agencies and recruiting firms offer minimal benefits, at best, to their temporary employees, so one might expect that agency temps should sue their agencies for better benefits. But that has not been the pattern. Instead, class action lawyers and the courts find it easier to attack the deeper pockets and greater vulnerability of large corporations.

One consequence of these lawsuits is that large corporations are feeling pressure to require that temp agencies offer better benefits to their temporary employees. The reasoning goes: If temp agencies offered decent benefits there would be little or no incentive for agency temps to sue client companies for back benefits. In this light, using the services of an employer of record like P.A.C.E. makes very good sense.

P.A.C.E. mitigates the risks of class action lawsuits

P.A.C.E. mitigates the risks of co-employment by collecting and paying employment taxes for its temporary employees. In this regard P.A.C.E. is like any other employer of record. But P.A.C.E. also *mitigates the risk of class action lawsuits* filed by disgruntled contingent workers for retroactive benefits. P.A.C.E. does so by offering *the best benefits package available to any employee in any company in the USA*.

In light of the *Viscaino v. Microsoft* Ruling (see below) it is fortunate that Microsoft uses P.A.C.E. as an approved vendor for its highly compensated contingent workers in both Washington and California.

Two Case Histories

Below is a discussion of two class action lawsuits where the courts have repeatedly ruled that the client companies must compensate their agency temps for retroactive

benefits. In the Microsoft case the critical factor was *length of service*. At the Metropolitan Water District of Southern California the critical factor was *client control*.

Microsoft

During the late 1980's Microsoft hired independent contractors to perform software testing, proof reading, technical writing, and related jobs under the close supervision of Microsoft employees. An IRS audit subsequently determined that these workers were in fact common law employees of Microsoft for payroll tax purposes. In response to this determination Microsoft offered full-time jobs to some of the independent contractors, and arranged for the remainder to work as leased employees through various approved staffing agencies.

Conventional wisdom would dictate that Microsoft had operated in good faith, and that its actions had successfully indemnified Microsoft from further claims of common law employment. Confident that it was operating within the law, Microsoft increased its use of agency temps throughout the 1990s to the point where, by some accounts, agency temps totaled one-third of all workers at Microsoft.

The 1990s was a decade of unprecedented prosperity for Microsoft employees who twice yearly were allowed to purchase the company's stock at a 15% discount. Hundreds of Microsoft employees became paper millionaires. Indeed, anyone who had purchased Microsoft stock on the open market did very well. It was just that Microsoft employees could purchase 15% more stock for the same investment through Microsoft's Employee Stock Purchase Plan.

Call it sour grapes, or call it righteous indignation, but the agency temps felt that they deserved a piece of that prosperity. They believed that they were entitled to purchase Microsoft stock at the same 15% discount as fully

franchised Microsoft employees. They wanted their piece of the prosperity pie, and they sued to get it in a series of class action lawsuits known collectively as *Viscaino v. Microsoft*.

Viscaino v. Microsoft coined a new term, *Permatemp*. Permatemp refers to an agency employee who works continuously at the same client for years on end. Many of the permatemps at Microsoft had worked side by side with Microsoft employees for as long as five years or more doing the same work under the same close supervision. Yet, they were denied the opportunity to become regular employees of Microsoft and participate in Microsoft's benefits package, including its lucrative Employee Stock Purchase Plan.

Over eight years and several appeals, the court repeatedly ruled that Microsoft had misclassified upwards of 8,000 long-term contractors as "temps" when they were in fact common-law employees of Microsoft, and that Microsoft had used that misclassification to illegally prevent the workers from participating in Microsoft's employee stock purchase plan.

Invoking the principle of co-employment, the court found that the plaintiffs were employees of their agencies for the purpose of payroll taxes, but were employees of Microsoft for the purpose of participating in Microsoft's Employee Stock Purchase Plan. Apparently, the workers were somehow not sufficiently co-employed to qualify for Microsoft's stock options, health insurance, and 401(k) plans.

In the end, the final judgment was for \$97 million, of which the plaintiff's attorneys will reportedly receive approximately 28%. In addition to this judgment is millions of dollars that Microsoft spent defending itself.

In response to *Viscaino v. Microsoft* the software giant has hired approximately 3000 of its permatemps as regular employees. Microsoft also has adopted a policy that limits staffing agency employees to a maximum tenure of 12 months, after which they may not return for 100 days.

www.CEHandbook.com

Bulletin: Are Your Approved Staffing Agencies Setting You Up?

Microsoft hopes that this remedy will be sufficient to eliminate the issue of permatemps, and avoid any future problems involving reclassification and co-employment of its agency temps.

There is an excellent legal brief published by the Information Technology Association of America (ITAA) that discusses the measures that companies can take to avoid *Viscaino v. Microsoft* consequences, www.ita.org/itserv/manalert.doc.

You will find additional background on *Viscaino v. Microsoft* at Washtech, www.washtech.org/wt/news/courts/display.php?ID_Content=106.

Metropolitan Water District of Southern California

The Metropolitan Water District of Southern California (MWD) supplies water to more than half of California's population. It is the largest water district in the United States. Now it has another distinction. MWD has just lost what may be the largest temporary employee lawsuit in the United States.

MWD downsized its headcount by laying off many of its *permanent* employees and then hiring them back as temporary workers through several third-party staffing agencies. The temps signed employment contracts with the agencies that clearly identified the workers as employees of their agency and not the water district.

As outside vendors, the agencies invoiced the water district for the workers' hours. They paid the workers' salaries, withheld taxes, and provided some benefits. The benefits, however, were significantly less than those provided to regular water district employees. The temps who had previously worked as regular employees of the water district lost the opportunity to continue their participation in the district's retirement plan through the California Public Employees Retirement System (CALPERS).

In their 1998 class action lawsuit the temporary workers charged that the water district hired and supervised them just like its own regular employees, making the workers common law employees of the Metropolitan Water District. The lawsuit further claimed that the district had kept the workers technically employed by outside staffing agencies in order to avoid paying for expensive CALPERS benefits.

The court ruled on behalf of the workers. According to the court, the agency temps were common law employees of the water district because the water district set their salaries and work schedules, made work assignments, and had the right to evaluate, promote, discipline, and fire them. Also, the court pointed out, the water district first interviewed and selected the workers it wanted before referring them to a staffing agency for employment. In other words, the water district had merely outsourced the payroll function to various staffing agencies while maintaining a common law employer-employee relationship with its workers.

The judgment against MWD will affect about 2,000 water district workers, and cost tens of millions of dollars in retroactive benefits, quite possibly eclipsing the landmark *Viscaino v. Microsoft* judgment.

Read the full court decision at www.bs-s.com/cargill.pdf.

Conclusion

It took eight years and many appeals to settle *Viscaino v. Microsoft*. The temporary employee lawsuit against The Metropolitan Water District of Southern California was settled after three years and one appeal. A precedent has been set, and additional class action lawsuits, including several already in the works, will be settled faster, and for a wider range of retroactive benefits.

www.CEHandbook.com

Bulletin: Are Your Approved Staffing Agencies Setting You Up?

The Microsoft judgment hinged on corporate compliance with federal ERISA regulations that mandate that employers make their Employee Stock Purchase Plans available to all employees, including their qualifying common law co-employees.

The Metropolitan Water District judgment widened the scope to include non-ERISA compliance in a government organization. What's next?

Can there be any doubt that predatory law firms are busily seeking out corporate targets for future class action lawsuits?

There is a moral here. *Any company that uses a staffing agency to payroll its temporary workers must ensure that the staffing agency gives those workers benefits that are at least as good as the benefits the company provides to its own employees.*

Any agency that provides only mediocre benefits (and what temp agency doesn't?) is exposing its clients to great financial risk.

Fortunately, P.A.C.E. mitigates the risk of class action lawsuits filed by predatory law firms on behalf of disgruntled contingent workers, and P.A.C.E. does this by offering ***the best benefits package available to any employee in any company in the USA.***

P.A.C.E. will employ contingent workers referred to your company through noncompliant recruiting firms and temp agencies. In turn, P.A.C.E. will pay a finder's fee equal to 10% of P.A.C.E.'s billing rate to compensate each referring agency for their placement efforts.

P.A.C.E.'s fee is just 5% of the billing rate plus the employer's share of actual payroll taxes and group benefit costs.

Contact P.A.C.E. today to learn how the unique **P.A.C.E. ProTrac** employer of record service offered exclusively by P.A.C.E. can shield your company from this new and significant threat to the corporate enterprise.

www.CEHandbook.com

Bulletin: Are Your Approved Staffing Agencies Setting You Up?

About the author

James R. Ziegler, Ph.D. writes extensively on issues affecting contract professionals. He directs the Contract Employee's Project consisting of The Contract Employee's Handbook, The Contract Employee's Newsletter, The Contract Employee's Workshop, and P.A.C.E. Send e-mail to ziegler@pacepros.com.

About P.A.C.E.

P.A.C.E. offers its employer of record service nationwide. The P.A.C.E. website is at www.pacepros.com/. The Contract Employee's Handbook is at www.cehandbook.com/.

Contact P.A.C.E.

Professional Association of Contract Employees
367 Civic Drive, Suite 15
Pleasant Hill, CA 94523
E-mail: admin@pacepros.com
Telephone: (925) 680-0200.