

MSPA-Americas

**Strategies for Satisfying an
'ABC' Test
For
Independent-Contractor Status**

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Important Information

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The Context

- Federal and state statutes governing the workplace generally (but not always) apply only to employees, but not to independent contractors
- For these statutes, a threshold issue is to ascertain the test used to distinguish covered employees from independent contractors
- Three most prevalent tests:
 - common-law test
 - economic realities test
 - **statutory ABC test (state only)**

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A Typical ABC Test

An individual **performing services for a given company** in exchange for pay is deemed an employee **unless** the company can demonstrate each of the following:

- A.** Such individual has been and will continue to be free from **control** or direction over the performance of such service, both **under his contract** of service and **in fact**; and
- B.** Such service is either:
 - outside the usual **course of the business** for which such service is performed, or
 - performed outside of all the **places of business** of the enterprise for which such service is performed; and
- C.** Such individual is customarily engaged in an independently established trade, occupation, profession, or business.

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A Typical ABC Test

All three factors of an “ABC” test are interrelated

- The “A” factor is the common-law test
- The “B” and “C” factors are considered in a common-law test, but are treated as mandatory factors in an “ABC” test

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Variations on the ABC Test

- ABC test = A factor [**common-law (“control”) test**] + B factor + C factor
 - Two versions of B factor:
 - **2-prong B factor:** the service is either (i) outside the usual **course of the business** for which such service is performed, or (ii) performed outside of all the **places of business** of the enterprise for which such service is performed
 - **1-prong B factor:** the service is outside the usual **course of the business** for which such service is performed – e.g., California and Massachusetts
- Other most common variations include:
 - A factor + (B or C factor) – e.g., Oklahoma
 - A factor + B factor – e.g., Pennsylvania

By definition, each is more demanding than the common-law test

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Applications of the ABC Test

- State unemployment taxes
- Worker misclassification, e.g., Illinois
- Employment laws, e.g., California, Illinois and New Jersey

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State-Specific Strategies for Deflecting an ABC Test

If company engages ICs to perform services for third-party clients

- Establish that an IC does not provide any services for the company and is not paid any remuneration by the company – to avoid the ABC test
- Consider: escrow account through which client payments are disbursed
 - Clients pay ICs through the escrow account
 - Escrow account divides client payment into IC portion and company portion
 - No commingling of escrow funds with company's operating funds

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State-Specific Strategies for Deflecting an ABC Test

- Some state statutes follow federal employment-tax treatment (can include Section 530 defense) e.g., Arizona
- **Arbitration Agreement prohibiting class-based claims**

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Strategies for Satisfying an ABC test

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The A Factor

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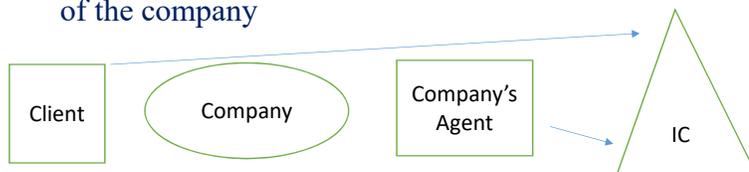
A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Need to show company lacks the right of control and direction over the IC both under contract and in fact

The company's contracts and its day-to-day operations must both satisfy this requirement

- **General rule:** control and direction over an IC **by someone other than the company** is not imputed to the company
 - unless the person providing the control and direction is shown to be an agent of the company



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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Need to show company lacks the right of control and direction over the IC both under contract and in fact

- No right to terminate a mystery shopper while the shopper is performing a client evaluation
- Client project descriptions should not be co-branded with the company's brand
- Do not select specific mystery shoppers for specific client opportunities but make the opportunities available to multiple shoppers
- It is helpful for a company to utilize third-party scheduling firms/website platforms

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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

- Terminology is critically important
- Avoid “employee” or “control” terminology in all documents and in all written and verbal communication with mystery shoppers, e.g.,
 - IC agreement
 - registration process
 - email communication
 - internal documentation
- No “payroll” or “employment application” for ICs
- No “instructions” no “time cards” [“invoice” is preferable]
- No possessive reference to ICs; not “our mystery shoppers” nor “our team”

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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Company **should**:

1. only define the objective to be accomplished
2. Permit ICs to accept or reject offered opportunities
3. permit ICs to determine when and where to work, when not essential to the project
4. negotiate fixed project fees with ICs, when possible
 - avoid nonnegotiable fees set by the company
5. report IC earnings on a Form 1099, when the IC earns at least \$600 during a calendar year, but never on a Form W-2
 - **if the company loses a state unemployment audit, the state cannot compel reporting on an IRS Form W-2**

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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Company **should avoid**:

1. training
2. instructions
3. monitoring or supervising an IC's performance of services
4. evaluating *performance*, as opposed to *outcomes*
5. requiring periodic reports on the status of the services being performed
6. required meetings with the company

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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Company **should avoid**:

7. being on-site while a mystery shopper performs services for a third-party client
8. policies or procedures relating to the services being performed
9. noncompete provisions or any restrictions on a mystery shopper's ability to obtain client opportunities through other sources
10. defining an IC's fees based on an hourly pay rate
11. providing tools equipment or supplies

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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Company **should avoid**:

12. reimbursing a mystery shopper for any out-of-pocket expenses; but only disburse reimbursements that a client provides
13. prohibiting an IC from hiring assistants or subcontractors, but OK to require a mystery shopper to inform the company to avoid the same shopper repeatedly evaluating the same location
14. retaining the right to terminate an IC, except upon a breach of contract
15. name badges or logo wear identifying the company
16. imposing any geographic restrictions on where an IC can perform services
17. covering an IC with its workers' compensation insurance or any other employer-sponsored benefits

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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Company **should avoid**:

18. requiring an IC to accept any minimum number of projects or to work any minimum number of hours
19. allowing company employees to perform mystery shop evaluations
20. imposing any unnecessary requirement
21. using words like “shall” and “must” in an IC agreement or in project materials

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A Factor

Individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact

Items to review:

1. independent contractor agreement
2. any forms or documents an IC completes or signs as a condition to contracting with the company
3. correspondence responding to third-party requests to confirm an IC’s employment and/or earnings
4. company policies, procedures and position descriptions concerning how company employees should interact with ICs
5. whether any company employees perform the same type of services as the ICs

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**The
B
Factor
1st Prong**

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B Factor

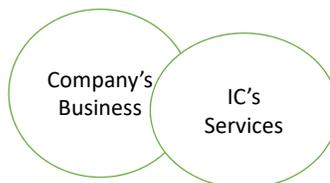
1st prong – the service is outside the usual course of the business for which such service is performed

Venn Diagram

Goal:



Avoid:



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B Factor

1st prong – the service is outside the usual course of the business for which such service is performed

- If a company regularly and continually performs an activity, **no matter its scale**, it is part of the company’s usual course of business
- A company may have more than one course of business
- How a company **self describes** its own business is generally viewed as highly indicative of the company’s business
 - although courts are split on whether a company’s advertising materials are necessarily determinative

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B Factor

1st prong – the service is outside the usual course of the business for which such service is performed

- A company should define its business as *something other than* providing the type of services it engages an IC to provide
 - For example, a broker/services referral agency should clearly identify itself as a broker/services referral agency and **not as a provider of the services that are provided by the ICs** who obtain client opportunities through the broker
 - Alternatively, a company can be in the business, e.g., of advising clients on improving and evaluating customer experience, and utilize **third-party** tools, such as mystery shoppers and customer surveys, to obtain data on the customer experience
- Defining a company as a “mystery shopping company” or as a “provider of mystery shopping services” – makes it difficult to argue that the services provided by mystery shoppers are *outside the company’s usual course of business*

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B Factor

1st prong – the service is outside the usual course of the business for which such service is performed

- The Nevada Supreme Court recognized that the businesses engaged in by a broker and respiratory technicians who obtained clients through the broker/agency are entirely separate from each other and that despite the fact that the agency profits solely from referring workers to clients, it could not ignore “the simple fact that providing patient care and brokering workers are two distinct businesses.”
- Moreover, the court further noted that, “We are convinced that the business of brokering health care workers does not translate into the business of treating patients for these purposes, and thus a temporary health care worker does not work in the usual course of an employment-broker’s business....”

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B Factor

1st prong – the service is outside the usual course of the business for which such service is performed

- Fact that a company depends on the services an IC provides does not necessarily mean those services are within the usual course of the company’s business
 - especially when the company has legitimately defined the boundaries of its operations and it outsources to ICs the functions it considers to be outside those boundaries
 - e.g., insurance company that only creates insurance products but does not sell them – independent insurance agents held to satisfy “B” factor
- In another case, the court reasoned that although a company derived its entire revenues from the services it provided to taxi drivers, and without the taxi drivers the company would have no revenue, the services provided by the taxi drivers were determined to be outside the usual course of the company’s business

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B Factor

1st prong – the service is outside the usual course of the business for which such service is performed

- Factors commonly considered include:
 - how the company describes its business
 - whether the company’s business is directly dependent on the **success** of an IC’s endeavors
 - e.g., company receives a percentage of revenues the ICs earn
 - whether the company is concerned with the **results** of the IC’s operations,
 - e.g., by providing training, or policies and procedures, relating to the performance of services

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B Factor

1st prong – the service is outside the usual course of the business for which such service is performed

- Factors commonly considered include:
 - whether the company takes an active role in ensuring that third parties for which an IC performs services are satisfied with the services provided
 - whether the IC wears or is required to wear name badges or logo wear identifying the company
 - whether the company represents the ICs to the public as part of the company’s staff (e.g., “our mystery shoppers”)

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B Factor

1st prong – the service is outside the usual course of the business for which such service is performed

Items to review:

1. website
2. independent contractor agreement
3. client agreement
4. marketing and advertising materials
5. internal documents describing the company's business
6. articles of incorporation and bylaws
7. self-description on government questionnaires, e.g., NAICS designation
8. correspondence responding to third-party requests to confirm an IC's employment and/or earnings
9. whether any company employees perform the same type of services as the ICs

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The B Factor 2nd Prong

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B Factor

2nd prong – the service is outside of all the places of business of the enterprise for which such service is performed

- Some courts define a company’s **place of business** as including a customer’s location where the ICs services are provided, when:
 - the company describes its business as providing the services the IC provides and
 - a company representative makes visits to those customer locations to assess the type of services the customer needs
- Some courts interpret a company’s place of business as including “**any location where the company’s business interests are represented,**” which, in one court decision, included a messenger’s travel from one location to another

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B Factor

2nd prong – the service is outside of all the places of business of the enterprise for which such service is performed

- One court has held that a firm’s place of business included a client facility based on findings that:
 - the firm is the exclusive provider of services at the facility and
 - any lapse in coverage or improper services performed by ICs would imperil the firm’s contract with the client
- The broad interpretation of this prong by some courts arguably converts the 2-prong B factor into a *de facto* 1-prong B factor, i.e., a super-integration factor

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B Factor

2nd prong – the service is outside of all the places of business of the enterprise for which such service is performed

- A company **should avoid**:
 - requiring an IC to provide services on the company's premises
 - requiring an IC to pick up materials, or submit reports, **in person** at the company's offices
 - requiring an IC to wear a badge or logo wear identifying the company while performing services (arguably suggesting that the IC is representing the company)
 - describing its business in a manner suggesting that the services an IC performs are in furtherance of its business

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B Factor

2nd prong – the service is outside of all the places of business of the enterprise for which such service is performed

Items to review:

1. website
2. independent contractor agreement
3. marketing and advertising materials
4. client agreement
5. policies and procedures regarding company badges and logo wear

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The C Factor

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

- Courts have interpreted this factor as intending to identify an individual who independently made the decision to go into business for him or herself
- Courts generally interpret this factor as being satisfied when an individual has a business, trade, occupation or profession that will clearly continue despite a termination of the relationship with the company
- The fact that a company **does not prohibit** an IC from performing services from others is generally **not sufficient**; rather, a company needs to prove that an individual **actually is customarily** engaged in an independently established trade, occupation or business

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

Factors commonly considered include:

- whether an IC *actually* performs services for clients other than the company
- whether the IC:
 - maintains an office, including a home office
 - is independently licensed by a government agency
 - has business cards, printed invoices
 - maintains the individual's own liability insurance
 - advertises the individual's services to third parties
 - has a capital investment in the business, such as vehicles and equipment
 - performs services under the individual's name

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

Factors commonly considered include:

- whether the IC:
 - has any employees or subcontractors
 - has a sellable business or going concern with established clientele
 - could operate independently of the company
 - realizes the profits and bears the losses of the business enterprise
 - reports the profits and losses from the business for federal tax purposes as business related items
 - maintains business records and tax forms

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

Factors commonly considered include:

- whether the IC:
 - maintains any required license or certification in the IC's own name
- whether the company represents the IC to third parties as an employee of the company or as part of the company's staff or team

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

Practical Problem:

- A company typically does not know whether an IC would satisfy this factor, because it has no “business reason” to know this information
- Often a company will not learn whether this factor is satisfied until after an investigation has commenced or a lawsuit has been filed

A Proactive Strategy:

- We developed a tool for ICs who want to be self-employed and have taken actions to establish an independent business – and want their clients, and potential clients, to know this – to memorialize their intentions and the actions they have taken

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

- We call the tool “CertifiedSE”
- CertifiedSE.com is **win-win** for ICs and their clients
 - Empowers legitimate ICs to obtain a competitive advantage relative to their peers by becoming a CertifiedSE and thereby demonstrating to clients and potential clients their intentions and the actions they have taken to establish their independent business
 - Can help a company mitigate its risk under the “C” factor by having access to the information a CertifiedSE submits to CertifiedSE.com
- We have promoted this tool to mystery shoppers at ShopperFest

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

How CertifiedSE.com works:

- Industry specific questionnaire
- IC renews certification annually
- IC agrees not to dispute veracity of responses to questions
- IC agrees that those responses can be shared with inquiring companies
- Possible use by an IC’s clients in identifying favorable IC witnesses in a dispute concerning the client’s classification of individuals as independent contractors

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C Factor

The individual is customarily engaged in an independently established trade, occupation, profession, or business

For more information about
 CertifiedSE, visit
www.CertifiedSE.com

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Status of ABC Tests

States in Which an "ABC" or "AB" Test is Applied for Unemployment Purposes		
Alaska	Louisiana	Oregon
Colorado	Maryland	Pennsylvania
Connecticut	Massachusetts	South Dakota
Delaware	Montana*	Utah
Georgia	Nebraska	Vermont
Hawaii	Nevada	Washington
Idaho	New Hampshire	West Virginia
Illinois	New Jersey	Wyoming
Indiana	New Mexico	

*Exemption Certificate issued under AB Test.

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Status of ABC Tests Recent Developments

California

A.B. 5 would codify the “ABC” test adopted by the California Supreme Court in the *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* decision for purposes of unemployment and the Labor Code.

- 12/3/2018: Introduced
- 5/29/2019: Passed by the state Assembly by a vote of 59 to 15.
- 6/12/2019: Referred to the Senate Committee on Labor, Public Employment and Retirement.

However, more states are replacing “ABC” tests with a “common-law” test...

- **Arkansas** H.B. 1850: **Enacted** 4/16/2019
- **Oklahoma** H.B. 1095: **Enacted** 5/10/2019
- **Tennessee** H.B. 539: **Enacted** 5/13/2019

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Any Questions?



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