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## Employment Issues Affecting Service Contractors

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# Agenda

- Fringe Benefits Under the Service Contract Act
- 1099s vs. Employees
- Nondisplacement of Qualified Workers Rule
- Employee Non-compete Provisions
- Additional Developments

# Fringe Benefits under the Service Contract Act

# SCA Requirements

- Pay minimum wages
- Provide “Health and Welfare” (H&W) or “Fringe” benefits
- To “service” employees
  - Wages and fringe benefit requirements are set forth in a Wage Determination (WD) appended to the contract
  - Fringe benefits must be furnished separate from and in addition to minimum wages
    - ✓ Excess wages cannot offset H&W deficiencies
  - Specified fringe benefits may be discharged by furnishing benefits valued at amount set forth in the WD or may be discharged by providing a cash equivalent
    - ✓ Must provide “bona fide” benefits

# Types of Fringe Benefits

- Collective Bargaining Agreement, Section 4(c)
- Holiday Pay
- Vacation Pay
- Single Rate of \$3.35
  - Effective June 1, 2009, except for WD requiring average benefit method, each employee must receive \$3.35 in cash or a cash equivalent benefit for all hours paid up to 40 hours per week
    - ✓ Hours paid includes all regular hours and paid time-off
    - ✓ Any shortfall must be paid by following pay period

# CBA Fringe Benefits

- Based on a Collective Bargaining Agreement
- Must be paid by a “successor contractor”
- Successor contractor need not pay the specific fringe benefits stipulated in the CBA; may provide “equivalent benefits”
- Cash payments may offset fringe benefits due



# *Bona Fide Fringe Benefits*

- Legally enforceable obligation
- Written plan communicated to affected employees with contributions made pursuant to plan
- Primary purpose of plan must be to provide for systematic payment of benefits to employees
- Plan must rely on formula for determining amount of contribution to be paid each service employee
- Contractor contributions must be irrevocable and made to a third party such as an insurer, trust or other funded arrangement
- Must be approved by the IRS 401(a)

# Examples of *Bona Fide* Fringe Benefits

- Health Insurance
- Dental Insurance
- Life Insurance
- Accidental Death and Dismemberment Insurance
- Sick leave, *if not required by WD*
- Vision Care Insurance
- Employer contributions to 401K
- ESOP, Pension Plan, or Thrift Plan
- Educational Assistance, *if not required by job*
- Severance Pay
- Paid Vacation/Holiday *in excess of WD requirement*
- Jury Duty, Military Leave, Bereavement and other paid leave, *in excess of that required by law*
- Other – *need approval by DOL*

# Not *Bona Fide* Fringe Benefits

- Payments required by federal or state law
  - (FICA, Unemployment Insurance, Worker's Comp)
- Benefits provided for the convenience of the company
  - Relocation
  - Incentive Awards
  - Tools
  - Uniforms not required by WD
  - Social functions/gifts
  - Professional or club membership dues
  - Administrative costs incurred in providing benefits

# 1099 or Employee?

# Employees vs. Ind. Contractors

## No Bright-Line Definitions of Employees and ICs

- There are risks associated with misclassification
- Misclassification has been and is fairly common
  - GAO Study
- Employee/IC classification is an issue often faced by government contractors

# Classification- Implications

- Many consequences of classification
  - Withholding for FICA and Medicare
    - ✓ Trust fund penalty
  - Withholding employee's state and federal income tax and the expense of maintaining payroll
  - Fair Labor Standards Act and minimum wage laws
  - Various employee protection statutes, such as ADA, ADEA, FMLA, etc.
  - Unemployment Insurance and Compensation
  - Virginia Workers Compensation Act- only applies to employees- there may be liability to ICs

# Additional Implications of Classification

- The National Labor Relations Act and the right to unionize
  - Only applies to employees and explicitly excludes ICs
  - Different judicial circuits have a tendency to focus on different factors
    - ✓ Fourth Circuit- the focus is on the Right to Control
    - ✓ DC Circuit- the focus is on Economic Realities Test
- Employment Retirement Income Security Act (ERISA)
  - Liability may be imposed on employers who allow ICs to participate in benefit plans; and
  - Liability may be imposed on an employer who fails to allow employees to participate in benefit plans because the employees are misclassified as IC

# Is this person an Employee?

- Several tests
  - Right to Control Test
    - ✓ IRS provides 20 factors
  - Economic Realities Test
    - ✓ Applied by DC Circuit in FedEx Home Delivery v. NLRB
    - ✓ The Economic Realities Test looks to see whether the worker has an opportunity to realize a profit or a loss for the work performed
  - Statutory Employees or ICs
    - There are a number of industry-specific statutes and regulations, e.g. real estate agents are defined as ICs



# Right to Control Test/IRS Factors

- The “Right to Control” Test
  - Generally, a worker is considered an employee if the worker is subject to another’s right to control the *manner* and *means* of performance
- The IRS 20 factor test
  - No Factor is determinative
  - Must look at all the factors on balance

# Recent Legislation and Enforcement Efforts

- Federal

- DOL's "Misclassification Initiative"

- ✓ Obama's proposed budget sets aside \$25 million for assisting DOL combat employee misclassification and will provide for 100 additional enforcement agents

- State-Virginia

- Several bills are before the General Assembly that impose criminal, as well as civil, penalties for willful misclassification

- ✓ Worker Misclassification Act

# Avoiding Problems

- Always use a written contract for ICs
  - Outline the scope of work and relationship
  - Limit the duration of the relationship
  - Never include a non-compete. Expressly include a provision stating that the IC can work for other entities
- Abide by the terms of the contract
  - Be careful of contract blurring

# Avoiding Problems, continued

- Make sure that ICs do not participate in any benefit plans
- Ensure that Employees and ICs do not perform the same functions and duties

# Nondisplacement of Qualified Workers Rule

# Executive Order 13495

- Signed by President Obama on January 30, 2009
- Establishes general policy of the USG w/regard to service contracts and solicitation of service contracts performed at the same or similar location
  - Policy promotes “economy and efficiency” in procurement
- Mandates inclusion of a contract clause that requires
  - “successor” contractor and its subcontractors
  - to offer predecessor employees,
    - ✓ whose employment would otherwise be terminated,
  - a right of first refusal for employment under the successor contract
  - in positions for which the predecessor employees are qualified

# Final Rule

- DOL regulations implementing EO published in the Federal Register on August 29, 2011
  - 76 Fed. Reg. 53720 (August 29, 2011)
  - Regulations may be found at Part 9 of the 29 CFR
- Not yet effective for solicitations/contracts, awaiting FARC guidance for inclusion of contract clause in solicitations/contracts
- Will be enforced by the Wage and Hour Division/DOL

# Exemptions to the Rule

- Contracts/subcontracts under the SAT
- Contracts awarded per blind/disabled programs
- Predecessor employees that work on federal and non-federal contracts
- Contracts exempted by a federal agency
  - Exemption will be narrowly interpreted, presumption that rule in government's best interest
  - Must be supported by a "reasoned and transparent" written analysis
  - Rule identifies appropriate and inappropriate factors that agency may consider



# Exceptions to the Rule

- Predecessor employee that will be retained by predecessor contractor
- Successor employees employed for at least 3 months that would be terminated if rule applied
- Predecessor employees that are not service employees
- Predecessor employees that had failed to perform
- Predecessor employees working on federal and nonfederal work

# Predecessor Contractor Obligations

- Must provide certified seniority list to Contracting Officer not less than 30 days before completion of the contract
- Must provide written notice to all service employees of their possible right to an offer of employment

# Successor Contractor Obligations

- No employment openings may be posted before successor contractor has offered a right of first refusal to predecessor employees
  - Continues for 90 days
- Must make a “bona fide,” express offer to predecessor employees
  - Who otherwise would be terminated
  - In positions for which predecessor employees are qualified
    - ✓ In determining if predecessor employee is qualified, successor contractor cannot apply its standard hiring standards
    - ✓ Successor contractor can apply screening procedures (drug tests, background checks etc.) only when such process is required by the contracting agency or contract
- Successor contractor can reduce staffing on contract

# What is a *bona fide* offer?

- Can be written or oral
- Must give predecessor employee a deadline by which employee must respond which is at least 10 days
- Contractor must make reasonable efforts to make offer in language predecessor employee understands
- Offer can be for different position than that previously held by employee
- Offer can be for a position providing different terms and conditions of employment than those that applied to predecessor position

# Non-Compete Provisions

# Non-Competition Agreements

- Where do things stand post *Home Paramount*?
  - *Home Paramount* is a seminal non-compete case decided by the Va. Supreme Court in November 2011

# Non-Competes and the Government Contractor

- Non-Competes may prove valuable to government contractors
  - May help prevent employees from soliciting clients
  - May assist employers in preventing the dissemination of sensitive or trade secret information to competitors

# Treatment of Non-Competes by the Courts

- How do courts review non-competes?
  - The non-compete, to be enforced, must be narrowly drawn to protect the employer's legitimate business interest, must not be unduly burdensome on the employee's ability to earn a living, and must not be against public policy



# What Do the Courts Look at to Determine Reasonableness ?

- The burden is on the employer to establish
  - Reasonableness of function
    - ✓ Must be a function related to employer's business
  - Reasonableness of geographic scope
    - ✓ Geographic scope must relate to where employer actually conducts business
  - Reasonableness of duration
    - ✓ No bright line but Va. courts seem suspicious of restrictions broader than 2-3 years

# Home Paramount Case

- Court had occasion to review a non-compete upheld in a prior ruling in 1989
- The non-compete prevented the employee from engaging directly or indirectly in the exterminating business
  - *“as an owner, agent, servant, representative, or employee, and/or as a member of a partnership and/or as an officer, director or stockholder of any corporation, or in any manner whatsoever, in any city, cities, county or counties in the state(s) in which the Employee works and/or in which the Employee was assigned during the two (2) years preceding the termination of the Employment Agreement and for a period of two (2) years from and after the date upon which he/she shall cease for any reason whatsoever to be an employee of Home Paramount.”*

# *Home Paramount- Court Ruling*

- Even though the Court upheld the identical non-compete in 1989, the Court struck this non-compete and ruled it is unenforceable
- The Court held that this provision was too broad because it prevented the employee from “engaging even indirectly, or concerning himself in any manner whatsoever, in the pest control business, even as a passive stockholder of a publicly traded company”

# *Home Paramount* ruling, continued

- The Court also held that the provision was too broad because the non-compete did not confine the function element of the provision to employer's actual business activities

## *Home Paramount- what do we take away?*

- Employers should avoid restricting employees' ability to be a passive investor in a competing business
- Non-compete restrictions should only seek to bar employees from engaging in business in which the employer actually is involved
- Non-compete restrictions should only bar employees from working with a competitor in a function similar to which the employee works for the current employer

# Other Possibilities

- If there is a basis to include a choice of law clause, include a different state's choice of law
  - Include a choice of law provision from a state which redlines or blue pencils non-competes
  - Usually need some nexus with a state before enforcing a choice of law clause

# Additional Developments

# New Personal Conflicts of Interest Clause

- Final Rule issued on November 2, 2011
  - 52.203-16, Preventing Personal Conflicts of Interest
  - Rule effective December 2, 2011
- Applies to contracts above \$150,000
- Applies to contracts that involve the performance of acquisition functions “closely associated with inherently governmental functions for, or on behalf of, a government agency”
  - Supporting, providing advice or recommendations regarding
  - Acquisition and contract administration functions



# What is a Personal Conflict of Interest?

- A situation in which a “covered employee” has a financial interest, personal activity or relationship that could impair the employee’s ability to act impartially and in the best interest of the Government when performing under the contract
  - Financial interests of employee’s family or other members of household
    - ✓ Commissions, referral fees
    - ✓ Consulting relationships
    - ✓ Investments
  - Prospective employment
  - Gifts including travel

# Contractor Obligations

- Screen “covered employees”
  - Required “covered employee” to disclose any interests affected by assignment to contract/task
  - “Covered employee” required to update disclosure
- Prevent PCI’s
  - Do not assign “covered employee” with PCI to contract/task
  - Prohibit use of “non-public” information
  - Obtain signed nondisclosure agreement
- Inform “covered employees” of their obligation to avoid even the appearance of a PCI
  - “Covered employee” should assume that all information given to a contractor has not been made public unless facts clearly indicate the contrary

# Contractor Obligations continued

- Maintain effective oversight
- Take appropriate disciplinary action
- Report any violation to the Contracting Officer
  - Include description of violation
  - Contractor corrective action measures
- Flow-down clause to applicable subcontracts
- Implicit three (3) year recordkeeping requirement

# Proposed OCI Rule

- Published in the Federal Register on April 26, 2011
- Significant rule
- Proposed separate coverage of “unfair competitive advantage” based on unequal access to non-public information
- Several new FAR clauses proposed

# New Proposed FAR Clauses

- Access to Nonpublic Information
  - Informs contractors on restrictions on use of nonpublic information
  - Requires contractors to obtain written nondisclosure agreements from employees
  - Two Alternates proposed
    - Includes contractor indemnification
    - Makes owner of nonpublic information a third-party beneficiary
- Release of Nonpublic Information
  - Obtains consent from contractor to release of nonpublic information to those contractors who need access to it for purposes of contract performance

# New Proposed FAR Clauses cont.

- Unequal Access to Nonpublic Information
  - Requires offerors to identify during a procurement whether it or any of its affiliates possess any nonpublic information relevant to the solicitation and provided by the Government
  - Requires certification of no firewall breach

# New Proposed Privacy Training FAR clause

- Published in Federal Register October 14, 2011
- Requires contractors to provide “privacy training” to employees who
  - Require access to a Government system of records;
  - Handle personally identifiable information; or
  - Design, develop, maintain, or operate a system of records on behalf of the Government
- Privacy training materials provided by the Government
- Initial and annual training required
- Does not apply to contracts for commercial items
- Contractor must keep records regarding compliance

# Questions?



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