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Ten Tips for Drafting Independent Contractor Agreements

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When you hire employees, you may or may not have written contracts; when you hire independent contractors, it is crazy not to.

Why the difference? Potential recharacterization from independent contractor to employee is always a one-way street. And while written contracts are important, drafting them is a virtual minefield.

And that minefield may get worse. On top of the enforcement tools available to the Internal Revenue Service and other agencies, Congress continues to introduce legislation intended to crack down on worker misclassification. In April, Sen. Sherrod Brown (D-Ohio) introduced the Employee Misclassification Prevention Act (S. 3254) to enhance worker access to fair labor standards, health and safety protections, as well as unemployment and workers compensation benefits. The Senate Health, Education, Labor and Pension (HELP) Committee held hearings June 17 on misclassification.

Committee Chair Tom Harkin (D-Iowa) characterized the problem as “staggering,” and referred to a Department of Labor study finding that as many as 30 percent of businesses misclassify workers. Based on a cooperative federal and state push, Harkin foresees increasing levels of audits and investigations. Also in the offing is a long-planned curtailment to an employ-

er’s ability to avoid the sting of recharacterization via so-called “Section 530 relief.”

All in all, businesses should be leveling increased attention to this area, and that certainly applies to contract drafting.

You may be tempted to rely on titles, affixing the “independent contractor” label but saying little more. If clients attempt to impose too many controls for the arrangement to be respected, the lawyer may need to adjust the client’s expectations. A modified arrangement may pass muster, or in some cases the client may need to change course and establish an employer/employee relationship.

Drafting independent contractor agreements presents daunting challenges, and many lawyers rely too heavily on forms and templates with no bearing on the facts. Forms can get you started, but discuss the dynamics with the client. Cover duration, exclusivity, location, hours, assistants, expenses, and more.

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This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.

Even sophisticated clients may need help with the nuances of contractor-versus-employee analysis. Consider each provision and how it impacts the worker’s status. More than with most contract drafting, there should be give and take between lawyer and client.

These discussions are not easy and involve many factors. Third parties often seek to recharacterize workers, and workers may contest their own status. After all, who is an employee is a legal and tax question not con-

trolled by a contract between private parties. To be effective in drafting, here are 10 tips you need to know.

1. Names and Titles

How the parties use labels is a fundamental indicator of intent. An agreement should state unequivocally that the person is performing services as an independent contractor, not an employee. Similarly, the agreement should be labeled an independent contractor agreement or consulting agreement. Avoid employee-sounding nomenclature.

2. Instructions and Training

A worker required to comply with the employer's instructions about when, where, and how to work is ordinarily an employee. Yet if you hire a contractor to install a swimming pool in your backyard, you can specify where you want the pool! The difference between contract specifications and ongoing instructions is important and is often overlooked in contract drafting.

Similarly, training workers (by requiring an experienced employee to work with them, requiring them to attend meetings, or other methods) may indicate the employer wants services performed in a particular manner. Ideally, make clear that the worker need not undergo training. Distinguish between existing skills and skills taught by the employer, either in the recitals or in the description of work to be performed by the independent contractor.

3. Right to Delegate, Hire Assistants, Etc.

Employers may be uncomfortable allowing workers to delegate duties, but it can be important to address it in the contract and tends to support independent contractor status. Optimally, an independent contractor agreement should specify that any helpers or assistants must be hired, supervised, and paid by the independent contractor.

4. Duration and Hours

There is no limit on contract duration, but short is better than long. Renewals may avoid extended duration, but a continuous 20-year relationship punctuated by 20 annual renewals may not be very persuasive.

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Hours set by the employer also suggest employee status. Of course, you might prohibit your home remodeler from noisy work past 7 p.m. and that by itself does not make the contractor your employee. Yet from a contract drafting point of view, putting scheduling in the worker's hands can help to support independent contractor characterization.

5. Full Time and Exclusivity

Classically, an independent contractor is free to seek other work. If a worker must work full time for one

company, that restricts other work. The agreement should make clear whether full-time work is required. An alternative to full time might be to set a deadline for a final product.

Similarly, an exclusivity requirement hurts independent contractor status, while a lack of exclusivity helps even if the worker does not choose to work for anyone else. Of course, exclusivity by itself is not fatal. Following a business sale, departing executives who consult usually cannot engage in competition, and that does not necessarily mean they are employees. No one factor controls.

6. Work Site and Reports

Work performed on the employer's premises suggests control, especially if it could be done elsewhere. Where possible, the agreement should allow the contractor to determine where to work.

Reports can also be telling, so try not to require periodic oral or written reports, or even to negate them. Often, oral or written reports are not mentioned one way or the other in a contract. Yet they commonly feature in disputes over worker status, as where the employer is accused of requiring progress reports, indicating control.

7. Payments and Expenses

Payment by the hour, week, or month generally suggests an employer/employee relationship, provided it is not merely a convenient way of paying a fixed sum for the job. A lump sum or progress payments for work completed is better than hourly, weekly, or monthly payments.

Also avoid reimbursements, since reimbursement of business or travel expenses may suggest an employer/employee relationship. Of course, travel expenses are routinely charged by attorneys, accountants, and other independent professionals. Whatever you do, make such provisions very clear.

8. Equipment and Investment

A person providing his own equipment, tools, and supplies is more likely to be an independent contractor, but be specific what tools and equipment you mean. For example, suppose an architect is furnished office and desk space, secretarial and telephone service, but provides his own drafting instruments and reference guides. The office, phone, and secretary will hurt the case for independent contractor treatment. Having an independent contractor bear his own costs tends to support his independence.

To avoid line-drawing, though, consider increasing the total contract price by the expected costs, and stating that the independent contractor must bear them.

9. Profit or Loss and the Public

If a worker risks economic loss due to significant investment or liability for expenses, it suggests independence. In drafting, avoid financial safety nets that preclude workers from experiencing losses.

Also, workers who make their services available to the general public seem independent. Sometimes the

possibility of other work is as important as actually doing it, so consider allowing the worker to advertise, etc.

10. Discharge and Termination

Classically, the right to discharge a worker for any reason suggests the worker is an employee. The idea is that the threat of dismissal causes the worker to obey instructions. An independent contractor, on the other hand, generally cannot be terminated as long as he or she meets contract specifications. Consider this model in drafting, even though reciprocal worker-company termination provisions (i.e., for any reason on 30 days notice) are often ignored.

The converse of the employer's right to discharge a worker is the worker's right to terminate. An independent contractor agreement may include detailed termination provisions that do not allow the contractor to terminate the arrangement at any time without liability. One model is payment for a finished product, with termination geared to a percentage of completion. In practice, though, a reciprocal 30-day termination may make sense and may obviate most of such issues.

Summing Up

The drafter must consider specifics, but keep in mind the fundamental question—whether the company has

the right to control the manner in which services are performed. Consider obligating the employer to pay for a finished product rather than allowing the company to direct each step leading to that finished product. Integration of the worker's services into the company's business can also show control, but integration is generally not something the drafter can address.

Independent contractor agreements often require workers to indemnify employers for taxes, penalties, and interest if workers are recharacterized as employees. Some employers believe this shows the employer did everything possible to insure the person was treated appropriately. Others believe it manifests doubt about the classification. I discount the latter, as IRS and other agencies are accustomed to indemnity provisions. Still, indemnity may not be worth much and I have never seen a company later try to enforce it.

Judgment is important, for there is room for disagreement about which provisions are most significant. Although contract drafting is challenging, a good agreement goes a long way toward securing independent contractor relationships. Yet no matter how thoroughly you draft, no independent contractor agreement is entirely safe from recharacterization. Still, the more thoughtfully you approach contract drafting the more your client is likely to have long-term success.