Drafting Independent Contractor Agreements

By Robert W. Wood


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Although drafting independent contractor agreements may seem to be a simple task that requires no special expertise, practitioners should take great care when doing that. An agreement should describe the business deal while taking into account the possibility that taxing or other authorities may seek to reclassify the worker as an employee.

Anyone who hires employees knows some of the risks and liabilities that entails. Employers are on the hook to pay wages, withhold and remit all applicable taxes, and more. Employers usually also have health insurance, pension, or other employee benefit obligations. They cannot violate workplace employment laws covering discrimination or working conditions.

More broadly, employers are responsible for all employees and where and how they do their jobs. If employees cause trouble — say, by getting into a car accident while on company business — under agency law the employer is liable, too. Given the stakes, it is curious that most employers do not have written contracts with the majority of their employees. There are many reasons for that.

One is that most employment and workplace laws apply regardless of what you put in a contract. That can make an employment contract superfluous in many situations. But when you hire independent contractors instead of employees, it is almost always a mistake *not* to have a written contract. Why the marked difference?

One reason is that it is extremely hard to defend a claim that an independent contractor is actually an employee without a written contract. A written contract is the first point of reference to govern the relationship. With no written contract, the worker is far more likely to be labeled an employee. Potential recharacterization from independent contractor to employee is always a one-way street.

Although written contracts with independent contractors are important, drafting them is a virtual minefield. The drafter must consider specifics but must remain aware of the fundamental question: Does the company have the right to control the manner in which services are performed? That can require considerable creativity.

Although contract drafting is challenging, a good agreement goes a long way toward securing independent contractor relationships. The more thoughtfully you approach contract drafting, the more likely you are to enjoy long-term success in the independent contractor relationship. Yet no matter how thoroughly you draft, no independent contractor agreement is entirely safe from recharacterization.

In drafting independent contractor agreements, many lawyers and business people rely too heavily on forms and templates with no bearing on the facts. Forms can get things started, but they must be read carefully and adapted to the specific situation. If you are a businessperson or human resource professional, consider enlisting experienced legal help. This type of contract is different from many others. You are trying to be clear about what is expected of each party and you want the agreement to be enforceable.

Some of the more obvious topics to address include pay, duration, exclusivity, location, hours, assistants, and expenses. But unlike most other contracts, an independent contractor agreement should consider the danger of recharacterization. Even sophisticated parties may need help with the nuances of the contractor versus employee analysis.

Consider each provision and how it affects the worker's status. If you are using a lawyer to help draft, make sure the process will be interactive and focused on the extent to which the independent contractor status of the worker is likely to withstand

scrutiny. There should be even more give-and-take between lawyer and client than there is with most contract drafting.

Those discussions aren't easy and involve many factors. Third parties often seek to recharacterize workers. Moreover, some independent contractors — who seemed content to be treated as such — may later contest their status and claim they were employees despite the independent contractor agreement they signed.

Many employers are surprised to find that signing an agreement does not estop the worker from arguing about it. However, the law is clear that who is an employee is a legal and tax question not controlled by a contract between private parties. Although most contracts may be private matters, an independent contractor agreement is not entirely private.

Any government agency can seek to examine the contract. Perhaps the company should have been paying taxes (or unemployment or workers' compensation) as treating the worker as an employee. Even private parties can scrutinize a contract if they are suing a worker and claiming they also can sue the employer because the worker was really an employee and not an independent contractor.

Although this following list is not exclusive, here are some drafting suggestions to consider:

Names and Titles

An agreement for an independent contractor should state unequivocally that the person is performing services as an independent contractor and *not* as an employee. Similarly, the agreement should be labeled an Independent Contractor Agreement or Consulting Agreement. How labels are used is a fundamental indicator of intent. One should not merely rely on titles, as simply affixing the ''independent contractor'' label.

Throughout the agreement, avoid employee-sounding nomenclature. As you draft, try to evaluate how the agreement would be interpreted by someone who is trying to attack the independent contractor relationship. Try to make sure that the agreement uses neutral terms or terms that only support independent contractor treatment.

Instructions and Training

A worker who is 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 certainly specify where you want the pool. The difference between contract specifications and ongoing instructions is important and is often overlooked.

Similarly, training workers (by requiring an experienced employee to work with them, requiring them to attend meetings, or other methods) may indicate that the employer wants services performed in a particular manner. Ideally, the contract should 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.

That also ties in to the worker's qualifications. If you are contracting with a qualified electrician to perform wiring and light fixture installation at your home or business it is unlikely that the electrician will need to be trained. It is also likely that the electrician is certified in a particular field or skill level. Those things help, so do as much as you can to emphasize them in the contract.

Right to Delegate, Hire Assistants, Etc.

Employers are often uncomfortable allowing workers to delegate their duties to others. However, it can be important to address those concerns in the contract. Allowing a worker to delegate some or all of the work to his subordinates 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. Also optimally, the contract will give the independent contractor the right to do as much of that as he likes as long as the work is done according to the contract specifications.

Duration and Hours

There is no limit on contract duration for an independent contractor. Even so, in terms of the likelihood that the independent contractor relationship will withstand scrutiny, a shorter term (perhaps a year or even much less) is preferable to a longer one. Renewals may avoid an extended duration.

However, do not assume that just because a one-year contract is renewed or signed anew each year that it's safe from recharacterization. After all, a continuous and exclusive 20-year relationship punctuated by 20 annual renewals does not suggest a short-term relationship. It still reflects a very long-term working relationship that, especially if it was full-time and exclusive, may be viewed as employment.

Required or permissible hours are another important matter for the contract. Hours set by the employer — for example, 9 a.m. to 5 p.m. every weekday — suggest employee status. This topic is sensitive with most companies. Even in an independent contractor arrangement, you may reasonably feel that you should be able to tell a worker — any worker — when to work.

However, remember that the essence of independent contractor work is that you are paying for a finished product or the results of a finished service. You should not worry over the details of *exactly* how the worker gets the job done. Of course, a homeowner might prohibit a home remodeler from noisy work past 7 p.m. That by itself does not make the contractor an employee.

Nevertheless, from a contract drafting point of view, putting scheduling within the purview of the independent contractor can help to support independent contractor characterization. As you draft, consider how the contract will be read by someone who is trying to claim that you ordered an independent contractor around to such an extent that he is really an employee.

Full-Time and Exclusivity

Classically, an independent contractor is free to seek other work at the same time he is working for you. If a worker must work full-time for one company, that has the effect of restricting or preventing 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 can be seen as inconsistent with independent contractor status. If you do not require the independent contractor to work for you exclusively, that should help show that the worker is truly an independent contractor. That is true even if the worker does not choose to work for anyone else. The fact that he *could have* can be significant.

One possibility for getting some of the benefits of exclusivity without actually stating it in the contract concerns noncompetition provisions. Consider prohibiting the independent contractor from competing with you in your business. Also consider including nondisclosure and confidentiality provisions. In some cases, those provisions can help get what you want without expressly requiring that the contractor work exclusively for you.

If you must have exclusivity, that by itself is not fatal to a claim of independent contractor status. For example, following a business sale, departing executives who do consulting work for the buyer usually cannot engage in competition. That is usually made clear in the consulting contract. However, it doesn't necessarily mean they are employees. No single factor is controlling.

Work Site

Work performed on the employer's premises suggests control over the worker. Therefore, having that requirement may suggest that the worker is an employee, especially if the work could be done elsewhere. When possible, the agreement should allow the independent contractor to determine where to perform the work.

In some cases, even if you make it possible for the worker to do the work at any location, you may be able to make it more convenient for the worker to do the work on your premises. The key should be whether the contract genuinely gives the independent contractor freedom to do the work at any location (and at any time), something that is more consistent with independent contractor treatment.

Progress Reports

Requiring that the worker provide periodic or regular progress or status reports can be telling. Try not to require periodic oral or written reports. They tend to suggest that you are interested in the method, manner, and means by which the worker will do the work, rather than merely the end product.

Often, oral or written reports are not mentioned in a contract, but they commonly feature in disputes over worker status. The employer may be accused of requiring progress reports (indicating control over the worker) even if the contract says nothing about them. For that reason, consider expressly stating in the independent contractor agreement that no progress or status reports are required.

Throughout the independent contractor agreement, remember that what should be most important is the end result or the finished product. The contract can be quite specific as to what that finished product might be. You can and should require compliance with the contract specifications. However, you should not have the right to *control* the method, manner, and means by which the independent contractor does the work.

Manner of Payments

It is usually possible to pay someone for goods or services in a variety of ways. However, you may need to think creatively about that. Payment by the hour, week, or month generally suggests an employer/employee relationship.

On the other hand, the mere fact that someone is paid by the hour does not make him an employee. Lawyers in private practice generally have many clients and are usually independent contractors whose status is not questioned and who frequently charge their clients by the hour. But in general, in terms of helping indicate an independent contractor relationship, lump or progress payments for work completed are normally better than hourly, weekly, or monthly payments.

Piecework payments are another common way of paying independent contractors. Test the compensation methods you select and compare alternatives. It is appropriate to run some examples and to try several approaches in achieving your compensation goals.

Who Bears Expenses?

Independent contractors are in business for themselves and therefore should generally bear their own expenses. When possible, avoid reimbursements. Reimbursement of business or travel expenses may suggest an employer/employee relationship.

Of course, reimbursements alone are not fatal to an independent contractor's characterization. Travel expenses are routinely charged by attorneys, accountants, and other independent professionals. Whatever the case, make provisions on this topic very clear in the written contract.

Equipment and Investment

A person providing his own equipment, tools, and supplies is more likely to be an independent contractor. Conversely, if the employer supplies the needed tools and equipment, that tends to be a strike against treating the worker as an independent contractor. Yet before drafting contract provisions about this, the pertinent tools and equipment must be considered.

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 probably hurt the case for independent contractor treatment. To avoid line-drawing, consider increasing the total contract price by the expected costs and stating that the independent contractor-consultant must bear them.

As that example shows, it is often possible through creative contract drafting to change the nature of the obligations between the company and the worker. Often, that can occur in a way that yields a similar economic result but that may be better from a legal perspective. Many of those steps may be small when viewed in isolation, but when combined, they may make the risk of recharacterizing the worker's status less likely.

Risk of Profit or Loss

If a worker risks economic loss because of significant investment or liability for expenses, that suggests independence and therefore tends to support independent contractor treatment. In drafting, avoid financial safety nets that preclude workers from experiencing losses.

Available to the Public

Workers who make their services available to the public seem independent and therefore are less likely to be recharacterized as employees. Sometimes the possibility of other work is as important as actually doing it; thus, consider allowing the worker to advertise. These contract provisions also tie into the discussion of exclusivity. If you are requiring an independent contractor to work exclusively for you, he is certainly not available to perform work for the public.

Discharge and Termination

Classically, the right to discharge a worker for any reason suggests the worker is an employee. The threat of dismissal is said to cause the worker to obey instructions. An independent contractor, on the other hand, generally cannot be terminated as long as he meets contract specifications. Nevertheless, reciprocal worker-company termination provisions (that is, either party can terminate the contract for any reason with 30 days' notice) are often ignored in assessing a worker's status.

The converse of the employer's right to discharge a worker is the worker's right to terminate the work relationship. 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 involves payment for a finished product, with termination geared to a percentage of completion. In practice, however, a reciprocal 30-day termination may make sense and may obviate most of those issues.

Indemnification?

Is it a good idea in the contract to acknowledge the possibility that someone may try to recharacterize the relationship as that of employment? There is no definitive answer to that question. Independent contractor agreements often require workers to indemnify employers for taxes, penalties, and interest if they are recharacterized as employees.

Some employers think clauses like that show they did everything possible to ensure that the worker was treated appropriately. Others believe that those provisions make it clear that the employer was thinking about the question and manifests doubt about the worker's classification. I generally do not believe that those provisions are red flags or that admitting to thinking about potential recharacterization is a bad thing.

The IRS and other agencies are accustomed to indemnity provisions in many different types of contracts. It does not mean that in each case the indemnity will be called into effect. However, I do often wonder about the worth of that type of indemnity provision as a practical matter. I have

seen many such provisions, but I have never seen a company later try to enforce one.

Conclusion

Use written contracts for independent contractors. Although form contracts can be a useful starting point, consider independent contactor agreements carefully. The business person or lawyer cares about more than setting forth the pertinent data and memorializing the agreement of the parties.

Indeed, the potential recharacterization to employee status is the elephant in the room. Potential recharacterization is a nuanced subject that can sometimes conflict with the arrangement the parties are seeking to document. Given the mix of topics and considerations, drafting independent contractor agreements is far more difficult than one might think.