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insights

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Technology companies: Are your employment policies due for a reboot?

"I'm a Silicon Valley guy. I just think people from Silicon Valley can do anything."

Elon Musk

"It's not magic. It's talent and sweat."

Gilfoyle, from HBO's "Silicon Valley

At any particular time, a technology company may devote all of its time and attention to an urgent development project, an investor pitch or closing a round of financing. Those activities certainly make for good press and television.

But there is a human element to technology development that is often overlooked, though equally important. In many ways, technology is "bespoke" and hand-crafted by highly skilled workers. Understanding some basic legal issues around those important resources can greatly increase the venture's success. Recent legal developments – and new regulations effective in December 2016 – significantly impact how technology businesses should think about their relationships with employees and how they manage those relationships to achieve value.

Investors and acquirors want their capital used for development and commercialization activities – not for the costs of high turnover or to deal with employee disputes – which leads them to ask sophisticated questions in due diligence about how the technology company handles its service providers. And, employees and independent contractors are happier and more productive when they know that they are being treated fairly. A relatively small investment to clarify relationships and policies will make a technology company at any stage of development more attractive to investors, purchasers, and to new hires.

Key employment considerations for tech companies

In this rapidly changing landscape, technology companies should review a few key areas of their business:

- How they have classified their workers to make sure they are satisfied that prior decisions about whether the worker is an employee or independent contractor still hold true.
- Whether employees are exempt under the FLSA and whether compensation and recordkeeping will comply with the requirements of the FLSA for non-exempt workers.
- If intellectual property assignment provisions in employment and independent contractor agreements match with how the worker is classified.
- Whether contracts with staffing agencies have appropriate provisions to assure that the agency complies with applicable labor laws, including the Affordable Care Act, indemnifies the company for any breaches, whether the agency carries adequate insurance for employment-related risks, and clarification of intellectual property ownership.
- The scope of the technology company's insurance coverage and whether there is adequate coverage for employment-related risks.

Independent contractor vs. employee

Most technology companies make liberal use of independent contractors to provide services. They find that the independent contractor model provides flexibility and reduces administrative costs associated with employees.

Workers classified as employees are entitled to many legal protections, and it is important to correctly determine whether a worker is an employee or independent contractor. A 2015 Department of Labor (DOL) interpretive release concerning the Fair Labor Standards Act (FLSA) significantly tilts the scale toward a default conclusion that a worker is an employee. In the view of the DOL, "most workers are employees under the FLSA's broad definitions… The act's intended expansive coverage for workers must be considered when applying the economic realities factors to determine whether a worker is an employee or an independent contractor."

The key element of the analysis for the DOL is whether the worker is economically dependent on the employer (and thus an employee) or is really in business for him or herself (and thus an independent contractor). For purposes of the FLSA, the DOL uses a six-part test to assess economic dependence or independence, which includes judgments about the nature and degree of control over the worker by the employer, whether the work performed is an integral part of the employer's business, and the degree to which the worker relies on his or her own skills, initiative, facilities and equipment to obtain and perform work. Attention is now being focused on the independent contractor status of Uber drivers and many other types of workers across the "gig" economy.

These factors vary by industry and circumstances, and all elements of the relationship must be examined. It is not necessary that an employer exercise daily control over the worker. For example, a worker may control his or her own work hours or may provide services from home or an offsite location but can still be an employee if the employer controls meaningful aspects of the work. In fact, under the DOL's analysis, the employer does not have to ***actually*** direct or control the way the work is done – as long as the employer ***has the right*** to direct and control the work.

It is common for (although not unique to) companies in the technology field to use workers thought to be independent contractors to provide services on a full-time basis for company-critical functions, doing work alongside or in lieu of employees. No matter what the contract between the company and worker says about their status, there is a risk that these workers will be characterized as employees.

A number of very important legal issues flow from whether the worker is classified as an employee or independent contractor. These issues touch on (among others) compensation, ownership of intellectual property, and liability for employer misconduct, all of which are central to the success of the technology company.

Wage and hour

Employees are subject to the minimum wage, overtime and recordkeeping rules of the FLSA unless an exemption applies, and starting in December 2016, new rules will take effect. Because in the technology world a 40-hour workweek is a quaint memory from the distant past, employers must be careful to determine whether wage and hour rules apply and to confirm which employees are exempt.

Two types of exemptions from the minimum wage and overtime pay requirements are particularly relevant to technology companies:

Computer Professionals: Under new rules to take effect December 1, 2016, a computer professional is exempt if he or she is paid at least $27.63 per hour or not less than $913 per week (an increase from $455 per week); and whose primary duties are any combination of: the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications; or design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications or machine operating systems.

The "computer employee exemption" does not cover all employees who work with computers. For example, employees whose work is highly dependent upon, or facilitated by, the use of computers and computer software programs are not likely to be exempt by reason of that work, nor are employees who repair computers or who staff help desks or help lines.

Highly Compensated Employees: Another set of exemptions that technology companies have historically relied on are based on compensation levels. Under the DOL rules effective in December, to qualify for this exemption a full-year employee must earn $47,476 or more annually (up from $23,660), and the "highly compensated exemption" will be increased to $134,004 per year (up from $100,000).

The new rules allow employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new standard salary level. And, while an employer can exclude any value or income received by the employees as a result of grants or rights provided under an equity award program from the regular rate of pay when computing "time-and-a-half" overtime pay (subject to certain criteria), equity awards do not constitute compensation to satisfy the employer's obligation to pay the minimum wage or overtime compensation.

Works for hire

Works of authorship – such as computer code, manuals and the like – created by an employee within the scope of his or her employment are generally considered a "work made for hire" and are owned automatically by the employer by virtue of the Copyright Act.

In most cases, works of authorship created by independent contractors are not a “work made for hire” (subject to certain exceptions rarely applicable to technology work). Because ownership does not vest in the company automatically – as it would for an employee – there must be a contract between the company and independent contractor in which the contractor specifically agrees that all works of authorship (and all other deliverables) are assigned to the company.

But with independent contractors, it may not be wise to simply use the same agreement employees sign with “work made for hire” language to convey intellectual property developments to the company. Because invoking the work for hire doctrine suggests an employer-employee relationship, technology companies should be careful to thoughtfully examine whether the intellectual property assignment language may undermine other portions of the agreement suggesting an independent contractor relationship.

Joint employer liability

A technology company that uses a staffing agency to provide programmers and other personnel to supplement its own workforce may find itself an unwitting joint employer with the agency. The 2015 ruling by the National Labor Relations Board in Browning-Ferris Industries of California, Inc. provided that a joint employment relationship may exist where an entity has indirect control over another entity’s workers or the right (even if unexercised) to control those workers.

In a 2015 federal appellate court case, a company was a joint employer of temporary employment agency-provided workers because the company provided day-to-day supervision, equipment and facilities for the work and had the right to exercise other elements of control. As the joint employer, the company was liable for the staffing agency’s discriminatory conduct toward the worker. Like a virus, liability for one joint employer’s wrongdoing to its employees can spread to others deemed to be joint employers.

The regulatory landscape covering employment relationships is evolving rapidly and dramatically, with unique impact on technology companies. Managing legal compliance with respect to employees and independent contractors both enhances performance and mitigates risk. It is a value-added activity and should be a critical element of any technology company’s growth plan.

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