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BUSINESS AND EMPLOYMENT NEWSLETTER

THIRD/FOURTH QUARTER 2010

WORKER MISCLASSIFICATION AND WAGE AND HOUR ENFORCEMENT IS ON THE RISE

By Amy Robinson

As you may have heard by now, federal and state government agencies have begun beefing up their enforcement efforts over the past year in an effort to address what they perceive as employers' rampant wage and hour violations and worker misclassification. In particular, the U.S. Department of Labor has added 150 new Wage and Hour Division (WHD) investigators, and 100 new investigators to enforce the American Recovery and Reinvestment Act (ARRA).[1] The influx of these 250 new investigators, as well as a 33% increase in staffing, is intended to aid the Department of Labor with reinvigorated enforcement of federal labor laws.[2] This ramping up is the result of a *very* damaging report by the Government Accountability Office (GAO) on the lack of enforcement by the Department of Labor and its lack of collaboration with the IRS on these issues.[3]

There is already clear proof of these increased efforts in our region. At the end of last year, the Department of Labor announced that a single investigation by the WHD recovered almost $1 million in back wages for 206 employees of a Seattle-based security company, HWA Inc.[4] In particular, the WHD investigators uncovered unpaid overtime as well as prevailing wage violations for employees on federal contracts held by HWA.

The IRS likewise announced its intent to audit 6000 companies of all types and sizes by random selection to check compliance over the next three years. These audits will focus particularly on employment tax issues, including proper reporting of fringe benefits such as company cars, gifts, and personal use of corporate-owned vacation property, as well as salary reporting for corporate officers.[5]

Congress also appears to be eyeing this issue seriously. In late April 2010, legislation was introduced in both the

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WORKER MISCLASSIFICATION—CONTINUED

House and Senate that would amend the Fair Labor Standards Act (FLSA) to build in additional safeguards against employee misclassification.[6] Here are a few of the proposed changes:

♦ An additional recordkeeping requirement that employers document the status of each worker as an employee or non-employee.

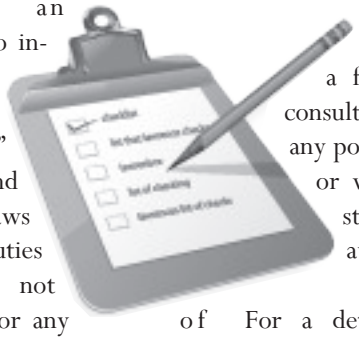
♦ Increased penalties for misclassification.

♦ A requirement that the business notify each worker in writing of their status as an employee or non-employee.

♦ Anti-retaliation protection for workers who seek proper classification.

And the momentum seems to be building. Just this past month, the Senate Committee on Health, Education, Labor & Pensions held a hearing on the issues involved with misclassification of workers as independent contractors entitled, "Leveling the Playing Field: Protecting Workers and Businesses affected by Misclassification."[7]

Likewise, we are seeing an increase in audit and investigations efforts related to employee misclassification at the state level, including the Department of Revenue, Labor & Industries, and Employment Security Department. Like their federal counterparts, this includes a particular focus on individuals providing services to a company being treated and reported as "independent contractors," but who in reality meet the applicable test for an "employee." It also includes misclassification of certain positions as "exempt" from the state and federal overtime laws where the actual duties of the position do not meet the standard for any of the various exemptions. This results in an employee who should have been paid overtime (i.e. time and one half) for each hour worked beyond forty (40) in any one week period, not receiving any overtime because the employer treats them as "salaried" – and thus have potential significant implications. Because Washington state law imposes additional penalties on employers who fail to properly pay wages to employees, if an employer knew or should have known that an employee was entitled to overtime and did not pay it, an employee could receive an award of not only the amount of overtime he or she had earned, but also an award of double that same amount as a penalty.



Given the inherent risks of misclassification of workers as *exempt v. non-exempt*, *employee v. independent contractor*, the complexities and fact-specific nature of the proper determination of each of those issues, and the increased enforcement efforts at every level, we strongly urge you to take a fresh look at this issue and consult with your counsel if you see any potential concerns or grey areas or want to discuss how best to structure your workforce to avoid these pitfalls.

For a detailed discussion about the problems with employee misclassification from the federal government's perspective, check out the GAO's full August 2009 report on Employee Misclassification at http://www.gao.gov/new.items/d09717.pdf.

INCREASE IN ANNUAL REPORT FILING FEES

The Secretary of State has announced that effective August 1, 2010, Annual Reports for Profit Corporations and Limited Liability Companies (LLCs) will increase from $59 to $69 a year.

1 Note that ARRA was the bill that extended the federal COBRA subsidy – discussed in the article above.

2 U.S. Department of Labor, Wage and Hour Division, Press Release, Release No. 09-0324-NAT, March 25, 2009, available at http://www.dol.gov/whd/media/press/whdpressVB3.asp?pressdoc=national/20090325.xml

3 GAO Report to Congressional Requesters, "EMPLOYEE MISCLASSIFICATION: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention," August 2009, http://www.gao.gov/new.items/d09717.pdf.

4 U.S. Department of Labor, Wage and Hour Division, Press Release, Release No. 09-1447-SEA, December 15, 2009, available at http://www.dol.gov/whd/media/press/whdpressVB3.asp?pressdoc=Western/20091215.xml

5 http://www.bloomberg.com/apps/news?pid=newsarchive&sid=anpR2t09GIeU

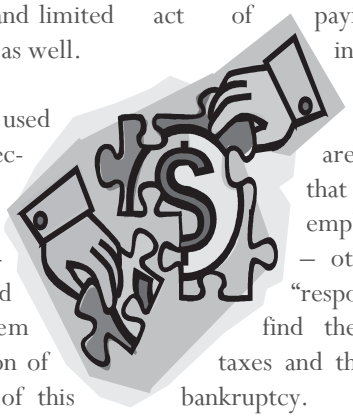
6 (See Employee Misclassification Prevention Act, H.R. 5107 at http://www.govtrack.us/congress/bill.xpd?bill=h111-5107; and S. 3254 at http://www.govtrack.us/congress/bill.xpd?bill=s111-3254.

7 For the list of panelists, testimony, and other information go to http://help.senate.gov/hearings/hearing/?id=225aa689-5056-9502-5d83-96cd13339413

CORPORATE LIABILITY PROTECTION

By Kirsten Barron

Many of you have formed entities for the liability protection offered to owners and officers. Whether a corporation or a limited liability company or a limited liability limited partnership, these types of entities offer a degree of liability protection to officers and shareholders. For purposes of this article, the word "corporate" applies to limited liability companies and limited liability limited partnerships as well.



The phrase that is typically used to describe the liability protection offered by an entity is "corporate shield," and it describes a barrier protecting individual owners and officers protecting them against liability for the action of the entity. The purpose of this article is to take a brief look at some of the areas where corporate officers, directors and owners can find themselves personally liable - without the benefit of the corporate shield. We call this "piercing the corporate veil."

A court will "pierce" the corporate shield when it believes that the use of the corporation constitutes an abuse of the entity. This can occur in circumstances such as when the corporation is undercapitalized, when the owners have failed to observe corporate formalities, and when failing to distinguish personal assets from corporate assets (i.e., paying personal expenses with corporate funds).

There are other situations that may result in "piercing the corporate veil" and liability to individuals.

Employee Obligations

Employee Withholding Obligations. One of the most common snares for corporate officers and directors is the personal liability trap of Section 6672 of the 1986 Internal Revenue Code. Section 6672 imposes personal liability on officers and other "responsible persons" in corporations for "willfully failing to pay over" to the IRS the employees' share of social security taxes and withholding taxes. Many times this "willful failure" can be shown by the otherwise innocent act of paying any other creditor in preference to the IRS when such taxes are owed. Clients are advised to ensure that this tax is paid on all employee compensation – otherwise officers and "responsible persons" can find themselves paying the taxes and the penalty – even in bankruptcy.

Failure to Pay Wages and Wrongful Withholding. Officers and corporate agents can find themselves facing personal liability for failing to pay wages and willfully depriving an employee of wages owed. It is extremely important to lay employees off or terminate them before you "run out of money," as filing bankruptcy does not relieve the company or individual of the obligation to pay wages. Additionally, when an employee's employment is terminated and the employee owes the corporation money (i.e., a loan, lost uniform) employers often want to offset any amounts owed against the employee's last paycheck. Unless the employee has agreed in writing to the withholding, such an action can likely result in the corporate officer or agent facing personal liability for double the amount of the withheld figure plus the terminated employee's attorney's fees under RCW 49.52.070. Similar liability can result from failing to pay overtime or other statutorily mandated amounts. See RCW 49.52.050(2).

Retail Sales Tax Liability.

The Washington State Legislature enacted another statute a few years ago that can also result in the personal liability of a corporate officer. Specifically, RCW 82.32.145 provides that a corporate officer or other person having control or supervision of retail sales tax collection shall be personally liable for unpaid taxes, interest and penalties where the responsible person willfully fails to pay (or causes not to be paid) retail sales taxes due from the corporation.

Unlawful Corporate Distributions Liability.

An additional area of personal liability exposure exists for corporate directors who assent to or vote for unlawful distributions of corporate funds, either during the life of the corporation, or in its liquidation. See RCW 23B.08.310 and 23B.06.400. The example most commonly cited by commentators is the distribution of a dividend which would render the corporation insolvent. These are typically actions where the entity gives money or property to its owners and officers when it cannot meet its obligations to third parties.

Hazardous Wastes Liability.

An area of rapidly expanding personal liability, including corporate officers and directors, is for the unlawful disposal or leakage of hazardous waste. This is a very complicated area of the law and the advice of counsel experienced in this area is

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HOW WILL HEALTH CARE REFORM IMPACT YOUR BUSINESS?

By Jamia Burns

The Patient Protection and Affordable Care Act (PPACA) and Health Care and Education Reconciliation Act (HCERA) (collectively "the Acts") will significantly change the health care system. The goal of health care reform is to expand access to health care, remove barriers and address affordability. The changes will be gradually implemented from now through 2018. Below are some of the key provisions that take effect within the next year. The Acts are complicated, so employers and plan sponsors should stay informed regarding ongoing developments in health care reform and should seek guidance from their insurance, tax and legal advisors on the best ways to be prepared for upcoming changes.

Key Employer Issues for 2010 and 2011:

Grandfathered plans. Some group health care plans in existence on March 23, 2010 will be "grandfathered" and therefore will be exempt from some of the changes.

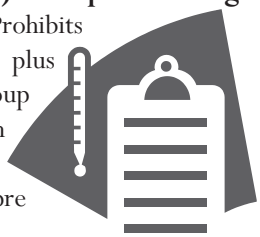
Small business tax credit. Some small businesses will qualify for a tax credit to make employee coverage more affordable. Tax credits of up to 35% of premiums will be available to firms that choose to offer coverage. Employers with no more than 25 full-time employees who are employed during the employer's tax year may be eligible if they meet other requirements listed in the PPACA. *Effective beginning calendar year 2010.*

Extends coverage for young people up to 26th birthday through parents' insurance. Requires new health plans and certain grandfathered plans to allow young people up to their 26th birthday to remain on their parents' insurance policy (even if married), at the parents' choice. *Effective 6 months after enactment.* Tax code change to permit tax-free coverage of dependents to age 26.

Bans lifetime limits on coverage. Prohibits health insurance companies from placing lifetime caps on coverage. *Effective 6 months after enactment.*

Bans restrictive annual limits on coverage. Tightly restricts the use of annual limits to ensure access to needed care in all new plans and grandfathered group health plans. *Effective 6 months after enactment.*

No discrimination against children (under 19) with pre-existing conditions. Prohibits new health plans plus grandfathered group health plans from denying coverage to children with pre-existing conditions. *Effective 6 months after enactment.* (Beginning in 2014, this prohibition would apply to all persons.)



Free preventive care under new private plans. Requires new private plans ("non-grandfathered" plans) to cover certain preventive services with no co-payments and make such services exempt from deductibles. *Effective 6 months after enactment.*

Early retiree medical re-insurance Pool.

Creates a temporary re-insurance program to help offset the costs of expensive premiums for employers and retirees for health benefits for retirees ages 55-64. *Effective in 2010.*

Requires Form W-2 reporting of health coverage. Employers must report the aggregate value of employer-sponsored group health plan coverage

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CORPORATE LIABILITY —CONTINUED

critical.

Wrongful Conduct.

Finally, Washington state case law supports the finding of personal liability of a corporate officer where that person participates in wrongful conduct or with knowledge approves of such conduct. For example, under this rule a corporate officer was found personally liable for his company's failure to provide construction financing as had been advertised by the corporation, an act that the court found was a violation of the Consumer Protection Act. RCW 19.86.020. Grayson v. Nordic Construction Company, 92 Wn.2d 548, 599 P.2d 1217 (1979). Wrongful conduct can also include fraud and criminal conduct, which will also likely result in the loss of the corporate shield. An owner, officer or director's breach of a fiduciary duty to the entity can also result in personal liability to those who breached such duty.

Paying special attention to these types of situations can help in avoiding personal liability.

HEALTH CARE REFORM IMPACT ON BUSINESS—CONTINUED

on employees' Forms W-2. *Effective 2011 taxable year* (provided to employees in 2012).

No health FSA / HRA / HSA reimbursements for over-the-counter medications (unless obtained with a prescription). *Effective 1/1/2011 regardless of plan year.*

Prohibits discrimination based on salary. Prohibits new group health plans from establishing any eligibility rules for health care coverage that have the effect of discriminating in favor of higher wage employees. *Effective 6 months after enactment.*

Holds insurance companies accountable for unreasonable rate hikes. Creates a grant program to support states in requiring health insurance companies to submit justification for all requested premium increases, and insurance companies with excessive or unjustified premium exchanges may not be able to participate in the new Health Insurance Exchanges. *Starting in plan year 2011.*

Interim high-risk pool for uninsured Americans with pre-existing conditions until exchange is available. Provides access to affordable insurance for Americans who are uninsured because of a pre-existing condition through a temporary subsidized high-risk pool. *Effective in 2010.*

Coverage cannot be rescinded. Bans insurance companies from dropping people from coverage when they get sick. Exceptions are where the individual has engaged in fraud or intentional misrepresentation. *Effective 6 months after enactment*

New appeals process. Ensures consumers in new plans have access to an effective internal and external appeals process to appeal decisions by their health insurance plan. *Effective 6 months after enactment.*

Community health centers. Funding will be increased for Community Health Centers that provide free or reduced care, doubling the number of patients seen by centers over the next 5 years. *Effective beginning in fiscal year 2011.*

For more information, check out these helpful resources:

Jane Beyer, Senior Counsel, WA State House of Representatives, May 4 2010. https://www.cornerstoneleadershiponline.com/downloads/HCR-1.pdf

The Making Sense of Health Care Reform handout https://www.cornerstoneleadershiponline.com/downloads/HCR-2.pdf

SO WHAT DOES THE HEALTH CARE REFORM ACT MEAN FOR EMPLOYERS *RIGHT NOW*?

By Amy Robinson

Thank you to Jamia Burns for her article about the impact of the new Health Care Reform Act on business. I want to take a moment to clarify a couple of provisions that have created some confusion for employers, and discuss what employers need to be acting on right now:

If you are an employer with less than 25 full-time equivalent employees (FTEs) and you offer health care, you may be eligible for a tax credit toward the costs of that coverage. Note: this 25 FTE eligibility means that you may be eligible for this tax credit even if you have more than 25 employees but less than that in full-time equivalents – this will be a good reason to review your job classifications to make sure they are accurate and up-to-date, if you haven't already. The FTE determination does, however, exclude seasonal workers.

Although you now have to provide health coverage for your employees' children up to the age of 26, you do not have to pay for all or any part of the costs of this coverage. There are also exceptions to the coverage requirement, including eligibility for coverage under another employer's plan.

The new law does not require you to extend health care coverage to your part-time employees if you don't already. However, it does provide some incentives, including government subsidies, to employers who do so. We recommend you take those incentives into account when you are considering how best to structure your workforce for maximum benefits.

Breast-feeding breaks for nursing mothers are now required by federal law. Specifically, the law requires that employers provide reasonable break time for up to one year following the birth of the child, and a place (other than a bathroom) for nursing mothers to be able to express milk. These breaks do not need to be compensated if they exceed any available compensable break time such as rest breaks. There are exemptions for employers with less than 50 employ-

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IMPORTANT EMPLOYER UPDATE: COBRA SUBSIDIES EXTENDED THROUGH MAY 31, 2010; ANOTHER EXTENSION STILL POSSIBLE

By Amy Robinson

Last year we briefed you on the American Recovery and Reinvestment Act of 2009 (the "ARRA") signed into law by President Obama in February 2009. ARRA created, among other things, a federal subsidy to be used for the payment of premiums for continuing health care for certain laid-off/involuntarily terminated workers under the Consolidated Omnibus Budget Reconciliation Act of 1985 (known as "COBRA").[1]

Since the enactment of ARRA, the federal subsidy has been available to cover 65% of the cost of COBRA premiums that would otherwise have been paid by eligible individuals[2] and extends the continuation coverage for an additional period of six months (i.e. from 9 to 15 months).[3] It was initially available only to employees who were laid-off or involuntarily terminated between September 1, 2008, and January 1, 2010. That period was later extended to March 31, 2010, and then again to May 31, 2010 by the Continuing Extension Act of 2010 (CEA). The premium reduction applies to periods of health coverage that began on or after February 17, 2009, and lasts until the individual becomes eligible for other group coverage (or Medicare, when the maximum period of COBRA coverage ends, or after 15 months of the reduction, whichever occurs first.

Under ARRA and the CEA, COBRA-covered employers must comply with the current notice requirements:

1. A General Notice must be given to all qualified beneficiaries (not just the covered employee) who experience a "qualifying event" anytime between September 1, 2008, and Mary 31, 2010 within the required timeframes.

Because the CEA that extended the subsidy from March 31, 2010, to May 31, 2010, was not signed into law until April 15, 2010, there are a few special accommodations made to address the delay and rectify any harm to qualified employees who would otherwise have received notice and availability of these benefits. For one, all individuals who experienced a qualifying event during that interim period are to be provided with the General Notice as soon as reasonably possible after the extension went into effect. They must then receive the full 60 days from the date that the updated notice was provided to make a COBRA election.

In addition, if an individual received a COBRA election notice that did not include information related to the most recent extension, they must also be provided with the updated information.

2. Provide a Notice of New Election Period that includes the required information about the COBRA enrollment extensions and the federal subsidy availability to all individuals who:

- ◊ Had a reduction in hours that would be considered a "qualifying event" under COBRA between September 1, 2008, and May 31, 2010;
- ◊ Were involuntarily terminated[4] between September 1, 2008, and May 31, 2010;
- ◊ Were terminated for any reason between April 1 and April 14, 2010; **and**
- ◊ Either did not elect COBRA continuation coverage when it was first offered OR elected but subsequently discontinued COBRA.

Likewise, we advise that you use the updated model notices published by the Department of Labor to avoid any inadvertent errors or omissions. See

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HEALTH CARE REFORM RIGHT NOW—CONTINUED

ees, where accommodating breast-feeding breaks would create an undue hardship. Given how "undue hardship" has been interpreted in other contexts, however, we expect it to be an exceedingly high threshold for an employer to establish, and therefore recommend that you consult with counsel before you deny breast-feeding breaks to an employee and when compliance questions arise.

Likewise, we recommend that you update your existing policies and employee handbooks to incorporate these mandated breaks. Feel free to consult with your legal counsel for guidance on the specific terms of the policy to suite your particular business needs and existing policies.

Most importantly, there are a host of incentives, penalties, and additional reporting requirements looming. Some will take effect in 2011, and some not until after 2014. We recommend you begin consulting with your professional tax, insurance and legal advisors now to conduct an in-depth analysis of your existing plans and evaluate your best options for the future.

For help in addressing these or any other changes in the law, please contact us or your employment counsel.

COBRA SUBSIDIES—CONTINUED

http://www.dol.gov/ebsa/COBRAmodelnotice.html.

It remains unclear, although possible, that Congress will again extend the subsidy period beyond May 31, 2010, though it appears there is lively and ongoing debate on Capitol Hill about extending it through the end of 2010. Until we have a clear answer from Congress, here's what Department of Labor said publicly with regard to the uncertainty:[5]

Release Date: July 6, 2010 Washington – *Assistant Secretary of Labor Phyllis C. Borzi today issued the following statement regarding the Consolidated Omnibus Budget Reconciliation Act (COBRA) and the premium reduction under the American Recovery and Reinvestment Act (ARRA):*

"ARRA provides a COBRA premium reduction for eligible individuals who are involuntarily terminated from employment through the end of May 2010. Due to the statutory sunset, the COBRA premium reduction under ARRA is not available for individuals who experience involuntary terminations after May 31, 2010. However, individuals who qualified on or before May 31, 2010 may continue to pay reduced premiums for up to 15 months, as long as they are not eligible for another group health plan or Medicare.

Unless the sunset date is extended by Congress, individuals who lose their jobs after May 31, 2010 will not be eligible for the subsidy.

Individuals who believe they have been incorrectly denied the subsidy may request the Employee Benefits Security Administration review their denial and issue a determination within 15 business days. The application to request a review is available at http://www.dol.gov/COBRA."

Given the uncertainty, if you are implementing or contemplating a termination this year during this post-May 31, 2010, interim period, you will want to make sure you have the latest information available to determine whether there is an additional extension or any other change to the law with which you need to comply in effecting that termination and communicating the appropriate notice.

In addition, here are some helpful links and resources to consult for information on this issue:

The DOL's dedicated COBRA website at www.dol.gov/COBRA. For specific questions, consider calling 1.866.444.3272 and speaking with an Employee Benefits Security Administration Benefits Advisor at the Department of Labor.

For information about the tax credit, compliance-related issues, or filing your quarterly Federal Tax Return Form 941 (http://www.irs.gov/pub/irs-pdf/f941.pdf), visit the IRS website at http://www.irs.gov/newsroom/article/0,,id=204505,00.html

We will of course do our best to keep you posted with new information and guidance as it becomes available. As always, for specific questions or additional guidance about COBRA compliance, including issues related to ARRA and the federal subsidy and what happens when the individual elects coverage, we recommend you consult your employment counsel.

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1 COBRA requires employers with 20 or more employees to offer employees and their families the opportunity to extend health coverage under a group health plan if it would otherwise terminate as a result of a qualifying termination event (i.e., death, disability, or termination of the employee's employment).

2 An "assistance eligible individual" is the employee or a member of his/her family who elects COBRA coverage timely following a qualifying event related to an involuntary termination of employment that occurs at any point from:

- ◊ September 1, 2008, through May 31, 2010; or
- ◊ March 2, 2010, through May 31, 2010 if:
  - the involuntary termination follows a qualifying event that was a reduction of hours; and
  - the reduction of hours occurred at any time from September 1, 2008, through May 31, 2010. (A reduction of hours is a qualifying event when the employee and his/her family lose coverage because the employee, though still employed, is no longer *working enough hours to satisfy the group health plan's eligibility requirements.)*

3 The subsidy is available only to fund the qualified individual's portion of continuation coverage. That means that if the employee is required to pay the full 100% (or more) of the premium, then only 35% of that amount must now be paid by the employee and the remaining 65% subsidized with federal money. If, however, the employer shares a portion of the costs of coverage, then the subsidy would apply to cover only 65% of the amount otherwise contributed by the employee.

4 Notwithstanding the express statutory terms, the Department of Labor has strongly recommended that notice be provided to all individuals terminated during the applicable period, given the risk of civil penalties if it is later determined that the termination was involuntary and notice was not provided.

5 http://www.dol.gov/ebsa/newsroom/2010/ebsa070610.html

A PERSONAL NOTE FROM THE DEPARTMENT:

By Kirsten Barron

The month of August in Bellingham – boats, beaches, relatively dry hiking paths – it may be the closest thing to heaven on this earth. While there are a few hearty souls that make their living in August – such as farmers and innkeepers – most of us experience a significant downturn in business for the month of August. After all, there is plenty of time to work when the rains come in October.

I took advantage of the August lull and went on a short sabbatical, which I highly recommend. Whether you want to finish a house project, write a book or watch every Hitchcock movie made – taking time to do something important to you can refresh you for your "regular" job. Many of us will work into our late 60s and early 70s - maybe even longer. It is a marathon – a long haul. We need to find ways to keep the journey fresh and alive and interesting.

We are still in uncertain economic times, which can be stressful. I find that the stress of this economy adds to the normal work stress folks have been experiencing for as long as I have been practicing law. As we head into October, I am back at work at full speed — drafting off of a great August.

The message in this note is one I also say to myself – take care of yourself and find ways to make this journey interesting and meaningful to you. I encourage you to take time to the things that refresh you and give you energy.

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