



NACCB Workshop: Independent Contractor Relations

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Table of Contents

| | |
|--|----|
| WORKING WITH INDEPENDENT CONTRACTORS | 4 |
| WHY SOME PEOPLE WANTED TO BE INDEPENDENT CONTRACTORS | 6 |
| CHARACTERISTICS OF AN INDEPENDENT CONTRACTOR | 8 |
| USING INDEPENDENT CONTRACTORS VERSUS USING EMPLOYEES | 9 |
| FINANCIAL ASPECTS OF PROVIDING SERVICES USING IC'S VS. EMPLOYEES | 11 |
| CONVERTING IC'S TO EMPLOYEES AFTER 1706 | 13 |
| CLIENTS' CONCERNS OVER THEIR LIABILITY | 15 |
| COMPETITION FOR IC'S AND TEMPORARY EMPLOYEES | 16 |
| NACCB MEMBERS' CONTRACT FOR USING IC'S | 18 |
| NACCB'S LEGAL DEFENSE FUND AND THE IRS | 18 |
| NACCB'S ROLE IN THE TAXPAYER'S BILL OF RIGHTS | 22 |
| CURRENT INTERPRETATION OF 1706 | 22 |
| EDUCATING CONGRESS ABOUT THE KNOWLEDGE-BASED ECONOMY | 26 |
| 1706 AND IRS STILL A THREAT TO CONTRACTING COMPANIES | 28 |
| PAYMENT PRACTICES IN THE INDUSTRY | 29 |
| COMPETITION FROM ICS WHO WORKED FOR A NACCB MEMBER | 31 |
| PROVIDING TRAINING TO CONTRACTORS | 32 |
| NACCB'S CODE OF ETHICS & SELF-POLICING OF THE INDUSTRY | 33 |
| RECRUITMENT OF FOREIGN LABOR | 34 |
| NACCB VS. ADAPSO | 36 |
| APPENDIX A: INDEPENDENT CONTRACTOR TEST | 38 |

NACCB Workshop: Independent Contractor Relations

Conducted by Software Industry SIG – Oral History Project

Abstract: The participants discussed their companies' and the IT service staffing industry's marketing, recruiting, retention, operations, payment policies, tax considerations, and other attributes as these differed between employee-based IT service staffing organizations vs. independent contractor-based organizations. The characteristics of employees vs. independent contractors were covered, as was the impact on staffing firms and their clients of IRC 1706 and the actions of NACCB.

Participants:

| <u>Name</u> | <u>Affiliation</u> |
|----------------|---|
| Dave Cassell | Pro-Access |
| Randal Evans | The ProVisio Group |
| Grace Gentry | Gentry Associates |
| Richard Gentry | Gentry Associates |
| Dan Greenburg | TSR Consulting |
| Jon Hahn | Independent Contractor |
| Luanne Johnson | Heights Information Technology Services |
| Jane Ross | JM Ross & Associates |
| Harvey Shulman | NACCB |
| Dan Williams | Interactive Business Systems |
| Jeff Yost | Historian, Charles Babbage Institute |

Luanne Johnson: This is a session to talk about the relationships your companies had with independent contractors and with your other resources, how all that worked, the different ways you approached those relationships, and the various issues which resulted, some of which we touched on this morning. What I would like to do is talk about recruiting and identifying those

people. Some people told the story about how they got started because they were working as an independent contractor, like Grace Gentry's story about the customer needing some more people and she kind of just grew from there. I would like to talk about once you were past that point where you needed other people, how did you go out and find the people who wanted to work in this independent contractor mode? Where did they come from? Who were these people that you hired? Did they come to you? Did you have to go find them? So let's hear different stories about that.

Working with Independent Contractors

Dan Greenburg: Well, I worked for a company called Howard Systems. After Howard, in 1982, I went to a company called TSR Consulting. TSR stood for Time Sharing Resources. The parent company was a timesharing company; and it had a huge mainframe it supplied for timesharing. The thing that attracted me to this company was that it was the first company that I knew about that had computerized all the applicants so that you could actually search by skills.

The personnel database was on a mainframe. This is even before the PC was really popular, so we had a real competitive edge. Everybody we met, we had them fill out a form. Everything went in the computer; and we built up the database. At that time it was like 3,000 or 4,000 people, which was a lot. It was just great that you could actually type in COBOL and get everybody's resume that had COBOL experience, as well as notes on their status and their availability. It was a real precursor to what companies take for granted now, so that really helped out.

We got most of our people from the advertising in the New York Times print editions. In the Sunday Times, the classified section was four or five pages of ads; and all it had was like a laundry list of skills that you needed for that week.

Johnson: So if somebody responded to one of those ads, they would then go in this database?

Greenburg: Yes, they would go in the database. Our company worked almost exclusively with 1099s, so we were known as a contracting shop. We had a very big technical screening process. It was a lot easier in the early 1980s because there were not that many skills. There were like four skills; and you were able to test people on it. We developed a really good database; and it made us a lot quicker than our competition.

Johnson: We are going to come back to you, Jon, since you were an independent contractor participating in this workshop session, you are in a different situation. We want to get your perspective on this, but I want to talk to some of the other people who were in the process

of trying to find people. One of the questions is, "Did you get a contract and then look for the people, or did you have people and then you looked for the contract"?

Grace Gentry: Both.

Johnson: Explain how it worked in a couple of different situations.

G. Gentry: When we first started in 1974, I had 25 file folders with the resumes of my best friends, most of whom were women in the field because it looked like a risky business. The women were all married; and they had their husband's benefits, so working by the hour as a contractor at these outrageously high rates of \$10 an hour looked like a very good deal to them. As time went on and we had more jobs to fill, we started running ads. You didn't run an ad for each separate job. You ran a long ad and would list the different skill sets you needed.

Once we had someone who performed well, we were really dedicated to trying to find that person another job and keep them as part of our group. They were proven talent. If we went into a client and the client had a job for that type of person, we could say, "This guy has worked for us for four years on six different contracts. He has always performed outstandingly." That was a big selling point.

As you worked with these people who were really good, one of the things we were able to do early in the industry was to help them continue to upgrade their skills. I would say to clients, "He's really a programmer right now. He'd love to do some analysis. We will charge you programmer's rates if you will let him do some analysis so he can add that to his ticket. You will get top talent because he will be very motivated and only pay programmer's rates."

And I would explain that to the candidate. First, I would get the candidate's agreement that this is what he or she wanted me to do. So it was both. It was finding a job, and if you had someone, finding a job for the contractor.

Johnson: That was also part of what differentiated you from your competitors, that you had a person with a particular set of skills.

Harvey Shulman: One reason that worked back then was that there were not really such things as closed vendor lists. If you had a skill set available and you heard that some customer needed something, you could market that independent contractor to almost anybody. They did not say, "You have to go through an RFP process and get on a vendor list and subcontract through so and so." The market was very different on the customer's side, which actually allowed that to happen.

G. Gentry: Yes. It was a very fluid market. In fact, when minicomputers first came in, they were new, and there were very few people out there, contractors or employees, who had experience on minicomputers. My husband Richard [Gentry] and I decided that we really wanted to develop strength in the minicomputer area because we saw this as a coming thing. But what did I have? I had IBM programmers. So, I would go to clients; and sometimes at a loss to us, I would sell them a mainframe programmer if they would let him or her work on a minicomputer.

We were building up a database of people with minicomputer talent. Then, as the minicomputer industry grew, we could take them into that type of job. I think everybody did different, innovative things.

Why Some People Wanted to be Independent Contractors

Dave Cassell: One of the things our clients said drove or opened up the opportunity for a lot of people to become independent contractors was because of the way the companies treated promotions. If you were technical and working for a client and you wanted to stay technical, but you got married and had kids and needed to make more money, you had no choice but to take a management job, even though you might not have the skills or the motivation to do it. We watched a lot of people whose careers were destroyed because, once they became managers they didn't have the skills and the motivation, but they could not go back down and work as a technician again.

So one of the things that we did was that we would tell people, "Hey, there is a new career available as an independent contractor; and we can help you sell your skills. We can help you set up and run your business. We can help you handle the administrative part of your business. We can provide you with insurance." We acted almost as a consulting firm to independent contractors.

Johnson: Yes, you mentioned that earlier, a focus to provide these services to these independent contractors.

Cassell: Exactly. That was a big selling point to the client, to say, "Look, we have taken these really strong technical people and now they are available to you and they like changing what they're doing." Every once in a while they came in with fresh, new ideas; and that seemed to work very well, particularly in the early days.

Dan Williams: I think another factor about the rise of independent contractors was that the economy was high and there was a flow of people toward dual income families. There was a lot of attention paid on the double healthcare coverage; and you really only needed that once in a

family. So one of them could become an independent contractor and get the higher wage. When we had a recession in the early 1990s, that contracted. Later on in the 1990s, it expanded again. Ten years later it contracted again.

Johnson: One of the points I wanted to cover was whether or not there was availability of this resource, whether there were surges and pullbacks on that. Sometimes there were lots of really good people out there that really wanted to work in this mode; and then later you are scrambling to find them?

Jane Ross: We found that when we first started our business, Computerworld was the big place to advertise; and we did the laundry list kind of advertisement. My husband was an independent contractor for many years. He went to Xerox to apply for a “real job,” and the guy said, “Well, did you ever consider working as a contractor?” That was the first time he had ever heard of it. The guy said, “I can pay you this much money;” and he said, “When do I start?” That is how we became familiar with working as an IC.

When his contract in St. Louis finished and there was not another one for him to go to, he started working for the company that had put him on the contract. They closed that office; and he just started selling on his own. We did not have a database. The PCs were just coming in. Faxes were the first big thing we had, a telephone and a fax machine. We advertised; and we used to file by skill set, not even by name. It was skill set: COBOL, FORTRAN. We sold to anybody that needed anybody of any kind with any skill set, rather than trying to target DEC or IBM or one of those markets.

We developed our own in-house database. It was on Alpha 4, which is an off-the-shelf database kind of thing, and set up our own fields so we could keep track of the things we wanted to keep track of. We liked having independent contractors. It was an easy way to run a business. It was beneficial to the contractors because they got to make a lot more money than they ever made anywhere else. Nine times out of ten their spouse had the health insurance, retirement, all those things. They didn't need to have it duplicated.

And it was easy to talk to people. Since Jim had the experience, he knew how to talk to them and be honest with them and not lead them down some stray path of how wonderful this is going to be. “Here are the pitfalls of being a 1099; and those are the things you need to watch out for. In the meantime, you can make some good money. Just make sure you save some of it.”

Characteristics of an Independent Contractor

Johnson: One of the things that came up at lunch was the issue of trying to understand the people, the characteristics of somebody who could succeed as an independent contractor. How did that factor in? You have got somebody with a skill set, but they may not have the other attributes it requires to function effectively.

Ross: You needed to find somebody who was a little bit of an entrepreneur, somebody who liked working for themselves, liked the idea of not having to be in the same job year after year after year and building up some kind of a retirement thing.

Johnson: How did you qualify them?

G. Gentry: There was a lot of self qualification. I knew people who were extremely talented technically, had great social skills. It was pretty obvious to me that they could be a good contractor; but they found the thought terrifying, not knowing where that next job was going to come from. Most of the time when people called you, they had already worked out for themselves that they could handle that.

Cassell: That worked out well for us as companies. The ideal independent contractor was one that could take contracts that they wanted to take and they could work on a contract for two years and then take off for six months and enjoy themselves. An incredibly small percentage of the people were really capable of doing that. We had a few; but most of them, the minute you are within two weeks of that contract ending, it was, "Where is the next contract coming from? I don't want to miss a paycheck." That worked out well for us because we had people that would bill 2,000; 2,200; 2,500 hours a year. I still think that fits most people today. And, Jon, you can probably address this, it is difficult to get comfortable as an independent, not knowing when your vacation is going to be.

Jon Hahn: Yes, it is very difficult to turn away work. I was able to take some month-long vacations; but I never did have the desire to take six months off. I know people who did; but it is really hard. It is hard to turn away work. I would overbook myself, too. Not to the point where it affected the work I was doing; but I was working a lot and really enjoying it. So I did not have a problem with that.

Shulman: I think anyone who listens to this now can take away a misimpression that using independent contractors was scamming the system, when you hear people say, "Independent contractors made more money." Ultimately, the client was going to pay a certain amount for the work. So really what happened is after the bill rate, how was everything else distributed? The independent contractors were smart enough to know that if they were not employed and their

FICA was not being paid and they weren't in a 401K, that they had these responsibilities themselves.

So why did they make more money? Some of them didn't really want health benefits because the spouse had it. A lot of these people, including ourselves, were young and were not interested in pension plans. They were interested in as much cash as possible so they could have a down payment for a house. The ones that wanted pension plans were really interested in setting up their own Keogh retirement plan.

Ultimately a lot of money flowed down because a lot of the firms doing this kind of work in NACCB were willing to either take a lesser profit or had less overhead than some of the larger established corporations, like CTG or EDS or whatever. It worked nicely for everyone in the picture. Jon just said, "Well, I took a vacation." If you were working for EDS or CTG and you finished a project, it is not like you could say, "I want to take five weeks off before my next assignment." That didn't happen.

I think it worked well because of the nature of the workers at the time and the flexibility of the brokers or independent contractor based professional services firms not to have some of the overhead and to be willing to sacrifice some of the profit margins these other companies had. I would be interested to hear from Dan [Williams] on this because there was a whole debate about whether Dan should be invited to the formation of NACCB.

The whole debate was that Dan was a company that used a bunch of independent contractors but also used a large number of employees. So the question was, which side would Dan be on? Was Dan the enemy? And yet I had the impression at the time that he felt he had the flexibility to do all the things he wanted to do. For those workers who wanted security, they had the W-2 path; and for those who wanted to take the risks and be paid a certain way, there was the independent contractor path. Ultimately, that proved to be what NACCB was all about. But, at the time, what was your reaction to all that?

Using Independent Contractors versus Using Employees

Williams: You are right, Harvey. We thought it was a better way to go because we could provide services at a lower cost if we took the risk of managing people's continuous employment. We would hire them and provide them salary, benefits, and that was cheaper per hour than hiring an independent contractor. We could take on the risk of continuing their employment for a long term on a large manufacturing account, a large manufacturing client, which was what we did most of back then.

We would also be resourceful enough to be able to bring on independent contractors for shorter duration, for special oddball skills that we didn't really want to keep with us for a long time. We did both, and, yes, at the inception of NACCB, we thought we were just like everybody else. We found out fairly quickly that I was not very welcome in some meetings because I was on the other side of the tracks. But not much, it was usually friendly.

Jeff Yost: For the salaried employees, did that allow you to make their jobs more secure because you had the flexibility of dealing with independent contractor staff?

Williams: Yes, back then their jobs were more secure. We ended up with some conflicts because we treated people differently. They were both sitting at the same desk doing the same kind of work; and they were being treated differently by us, their employer. So we had HR type issues.

Johnson: Did they have any choice in that? Could they switch from one side to the other? Did you allow them to do that if they were really unhappy with the side they were on?

Williams: We had to control the amount of flipping that they were going to be allowed to do because you could easily get in trouble with the IRS.

Cassell: How long would you keep them on the payroll if they were not billing before you let them go, on the average?

Williams: We took that into account, too. It varied on how badly we needed the person, how skillful they were, how helpful they were in bringing us business and if we needed that skill for a long time.

Cassell: That was always one of our selling points, using independents, was, "Yes, these guys promise they are going to keep you on the payroll." They would come back to the office three days later and if they don't have a job for them, they let them go. It was a good selling pitch up front, and there were a lot of companies that did that. Clearly, there were also companies that would keep them on the bench, if this was a skill that you knew was going to be in demand in the future, you would make that investment.

Williams: It was a good selling point, also, for us, Dave. We could tell them, "Look, this is the way it is going to be. Otherwise, you have got to go to one of those contractor shops where they would cut you loose as soon as the last dime comes in."

Financial Aspects of Providing Services Using IC's vs. Employees

Johnson: One of the people at IBM within the Information Technology Services division who was one of the more thoughtful and less radical people, not the ones out leading this big battle - when internally they are talking about, "Oh, these guys are saving so much money because they are not paying the employers' taxes," he came to me and said, "The real differential is paying these people if you're committed to keeping them on payroll and paying them for the time they are not billing." He said, "That's the real differential. As far as we are concerned, it is worth it because we are very selective about whom we hire and we want to keep them." He said, "That is really what makes it more expensive to do it this way. The taxes have nothing to do with it."

Shulman: I can say, based on NACCB operating survey information at the time and also based on a number of M&A deals that I was involved in, sometimes representing the buyer and sometimes representing the seller, the truth is most companies that were employee-based, particularly salaried employee based, typically were more profitable than companies that used independent contractors.

There were so many myths created about Internal Revenue Code Section 1706 that people are cheating the government; and that proved, through Treasury Department analysis, to be untrue. The data actually showed that the IT services industry, particularly so-called brokers and their workers, were much more highly compliant than other independent contractor industries. The myth was that the workers were getting squeezed, that the companies that use independent contractors were more profitable because they were not paying taxes and they were not providing benefits. In fact, the data was that salaried employee-based companies were more profitable than brokers who used independent contractors.

So, all of this myth and intuition that there must be something wrong for business to be done this way proved to be exactly that, a myth. What I found is that the brokers were responding to a need out there, and that the workers wanted to work this way. The customers thought it was flexible. It was not a tax scam. It was not anything else.

In fact, it actually created and contributed to technology transfer as workers who were independents tended to float from one company to the next to the next to the next. They brought with them their different skill sets, as opposed to if you worked for EDS for so many years. Typically that is what they had you do (i.e. the same technical things) because they could keep raising the billing rate but they would not have to raise your salary in relation to the billing rate going up.

So I hope that one of the things that comes out of these discussions is to dispel a lot of the pejorative myths about what was behind the use of independent contractors and to really

understand that it was not tax motivated at all. In fact, it was responding to both the technological need and a social or personal need that people had to structure their lives a certain way.

G. Gentry: Also, when the huge layoffs started at different times in the computer industry, a lot of individuals who had thought they would go to work for IBM for 20 to 30 years and then retire - or Hewlett Packard or whatever - realized that that was not necessarily going to happen because those companies would do huge layoffs. They would say to me, "There is no security out there anymore. The only person who cares about me and is going to take care of me is myself." So they preferred to work as an independent contractor and take care of their own benefits, retirement plan, whatever, because at that point that was the only person they trusted. Companies went bankrupt, and their retirement funds turned out to be unfunded.

Hahn: If I may make a comment about the benefits, as far as your personal benefits, I saw that as a big advantage because I did not need a lot of the benefits that I was getting as a full-time employee. So I can scale it down and pay for what I want.

Also, the thing that comes up about retirement - because I got out of college in 1981 and I had two jobs in three years. I was pretty disillusioned. It became pretty evident that I was never going to be at one of these companies long enough to vest in their pension plan. They might have been great defined benefit pension plans; but I was never going to participate in them. My first job was at Ampex; and I was there when they laid off a lot of people. I was a new hire; and they were even laying off old-timers. So I did not have a lot of faith in their pension plan.

As an independent contractor I had access to a great pension plan. I was earning a really good income. I could put away 15 percent of it. That was a huge tax advantage to me.

Cassell: And you could put away up to 30 percent.

Hahn: Under certain circumstances you could; but it was more difficult. I thought 15 percent was plenty, although I think I was really in the minority. I don't think most independent contractors fully vested in their own pension, but I did. Because I did not own a house, that was the only tax advantage available to me.

Randal Evans: That's one of the things that I think is a myth about independent contractors. A lot of them wanted to be an independent contractor because they made more money. The problem is, most of them still lived paycheck to paycheck. Having come out of the contract market myself as a contractor, when I started my business I thought there were two things I wanted to do. One, I wanted to put together a business model that showed people that I really cared about them as individuals; and, two, I definitely believed in golden handcuffs.

The way I used golden handcuffs was when I came out with this \$5 an hour margin that nobody else in Houston matched. Everybody came calling. Anybody who was a contractor at the time would call me and say, "Hey, you got a job for me? I want to come work for you. I understand you only take \$5." I said, "That's right. And even better than that, when I can get an increase in your rate, you get 100 percent of it. I'll take \$5 forever." They never wanted to leave because they could not get a better deal anywhere else.

Cassell: Now you have to also understand that the reason he was able to do this was that he was contracting at Exxon and had access to all of the managers that were hiring at Exxon. Until we got that fixed for you.

Evans: Let me say that was one of the best things you ever did for me. Once Exxon came to me and said, "You know, we love you; but all your competitors are complaining about your working here and placing contractors. We think it is time that you should leave."

Cassell: Didn't they give you a choice? You either got to be a contractor or be in the contracting business?

Evans: There was no choice there. I had too many people working for me. So I said, "Okay, I will leave." I then got to spend 100 percent of my time doing this work, because before then every night I was up until two or three o'clock in the morning writing resumes. In the long run it would have killed me.

With that kind of a model I was able to attract the best contractors in town; and I never had to worry about turnover. It created my own resume source or my own candidate source without me doing a whole lot of work. As soon as word got out of what I was doing, I had more phone calls than I could handle.

Converting IC's to Employees after 1706

Shulman: What happened when you eventually started shifting your workforce to employee based?

Evans: When I had to do the conversion - because Exxon was one of those companies that required everybody to convert to W-2s and, obviously, they didn't want you to raise any rates to cover that. I went to the entire workforce and said, "Look, you know I've been the cheapest guy out there. You have made more money with me. In order to do this, you are going to have to eat the whole cost." And I did not have any complaints at all.

Johnson: Really?

Evans: Yes, because they understood that for those few years that they were working for me before all this happened, that I had done right by them the whole time. I had lived up to what I said I would do. So when I came to them, they saw this as something that was out of my control. I had to do it. I had no choice. I only took an extra \$2.50 to cover taxes - so they were still getting a heck of a deal compared to the rest of the marketplace.

Johnson: What timeframe was this, that you were required to do that?

Evans: They had to be converted by January of 1988.

Johnson: So this was the timeframe that it began to hit everybody?

Hahn: In 1987.

Gentry: That was IRC 1706.

Shulman: It was with the birth of NACCB.

Johnson: So a lot of the customers forced that because they were concerned that they had liabilities. Is that it?

Evans: Oh, absolutely.

Greenburg: They misread the law, I think, because IRC 1706 only applied to two party situations -- not to three party situations; and it only affected the liability of the broker, not the liability of the employer. I think they just wanted to play it safe and took a very conservative position; they did not read the law.

Shulman: Well, we have to remember that the anti-independent contractor fervor was being whipped up by a number of companies that were employee based. So, for example, Oxford out of New England was putting on seminars around the country where one of the officers of Oxford would visit. The ad would say in the newspaper, "Are you waving a red flag in front of a bull? If you are a customer working with a company that uses independent contractors, you are asking for trouble with the IRS." These were in newspapers.

They would run these programs; and they would get customer representatives leaving there terrified. Because of this new law, which nobody really knew what it meant until there was some clarification issued, customers started reacting to the point that in New York City, Goldman Sachs and a lot of the financial services clients that had been using independent contractors,

were re-issuing contracts to all the staffing firms, saying, "You have 60 days or three months or whatever it is. Everyone here has to be a W-2; and if you do not do that, you are out."

What you experienced was happening in a lot of places around the country. It wasn't just because the new law was passed. It was after it was passed. There was a very effective scare campaign carried on by a number of individual companies, as well as NTSA [National Technical Services Association]

Johnson: These guys went to their clients because they were employee-based firms, and I am sure they were using that as leverage

Yost: Scare tactics affect different types of customers differently. What about the big corporations versus the small ones?

Cassell: Yes, if they had a lawyer on staff... I mean, what do lawyers do? Their job is to protect their clients. So you go overboard; and we experienced a lot of that.

Evans: We saw a lot of companies take on these policies where - most of my people stayed with me in the same contract for five years - but once 1706 came out and the lawyers started looking at employee law and benefit issues and things like that, they started taking approaches where they would say, "Look, after two years you have to leave."

Greenburg: Even if you're a W-2.

Clients' Concerns over Their Liability

G. Gentry: Let me clarify what he was saying. One of the reasons that many of the client companies set up this "two years and you're out" and "13 months and you're out" policy is because they became afraid that the independent contractor - or even the hourly W-2 employee - was not going to be found to be the employee of the contracting agency but theirs. They were going to owe not just back taxes - if those had not been paid - they were going to have to pay pension plans, stock vesting, all sorts of things. Their attorneys became concerned about that.

Evans: There was some valid concern there. For example, there was a contract secretary who worked at Exxon for ten years. The temp firm that she worked for did not provide any benefits. When she decided to retire, she sued Exxon and won.

Shulman: What people overlook is that one of the really important court decisions that came down involved a technical person at Exxon; Abraham was his last name. He had the

same lawsuit and said, "I was a programmer or engineer." In a Federal Appeals Court decision they said, "No, you are not an employee of Exxon."

This person was sent there by a staffing firm; and I believe the person was an employee of the staffing firm but was saying, "I have been at Exxon all these years as a so-called independent contractor, employed by the staffing firm; but I am treated just like Exxon employees. I want all the benefits, healthcare and pension benefits." In fact, that decision and many other court decisions in other parts of the country came out favorably for the customers and against the workers. Those stories do not get told because that is the dog bites man story. The man bites dog story is where some independent contractor found a judge someplace and won.

The Microsoft case story was totally misrepresented because - as everyone who knew the case understood - the IRS audited Microsoft for using independent contractors directly. Microsoft did a very stupid thing. Instead of just saying, "Okay, we'll settle, we'll pay the taxes on these people," Microsoft actually signed a document that said, "These people, these independent contractors, are really our employees; and because of that, we will pay taxes on them."

Once the workers found out that Microsoft said, "They are Microsoft employees," the workers brought a class action suit, saying, "Since we are employees, we want stock. We want health insurance." Of course, Microsoft lost the case; and they did something even more stupid. They took the people who they said were their employees and started payrolling them, not through a staffing firm, but what was essentially a leasing company. Then the court ruled, "Even though you are being W-2'd by the leasing company, you are still a Microsoft employee entitled to benefits even though you are getting your W-2 from someone else." The Microsoft case, both after and before, is probably the only exception to all these other court rulings which found otherwise.

Evans: The Microsoft case - in my opinion - makes my point about corporate lawyers. Here is Microsoft doing very stupid things about the whole issue of whose employees they are. I always found that, dealing with corporate attorneys, the mindset was ultra conservative, ultra protective and always look at the worst case scenario and manage against that. Therefore, your corporate attorneys would always take the approach of making sure that nothing could possibly damage the company, as opposed to taking any risk whatsoever.

Competition for IC's and Temporary Employees

Johnson: Talking earlier about where did you get your contractors, what I was hearing was that there really was not a shortage. This really was not a big issue. There were enough people out there, skilled people who wanted to work in this mode, that finding them was really not an issue.

Greenburg: You had to have skilled recruiters. It was a very competitive business in terms of finding the labor pool, especially in the times before the recession.

Johnson: So you were competing with your competitors not just for clients but also for ICs?

Greenburg: Oh, yes. We were all fishing from the same pool a lot of times.

Shulman: We created a lot of opportunities for new companies to come in the business because we couldn't get enough resources.

Greenburg: Right. The cost of entry into our business was a quarter. If you had a phone booth, you were fine because it was very low cost of entry. What would happen is that the competitor would have the same requirement that we would, and we had to get on the phone right away to call a person who is available. Many times we were five minutes ahead of the other guy who called, or maybe five minutes behind because we were all sort of fishing from the same pool.

Johnson: And you might be going after the same customer on this?

Greenburg: Same customer and same consultant, and so you had to be very fast. You had to be very committed. That is why I said that the computerized system that was developed was really very powerful, because it enabled our recruiters to really hurry up. Our motto was "Understand the Urgency" for our recruiters. We had that plastered all over the place. It was a very competitive business.

Cassell: Today you have the computers calling.

G. Gentry: Yes, but I thought that he was asking about the general pool. You could, for instance, have to go in and recruit people out of permanent jobs. We never had to do that. At least we never had to do that in the Bay Area. People came forward and applied for the jobs.

Johnson: Now this was very interesting. I'm glad we got this as part of the record. I had not thought of that aspect of it.

But where I was going was whether or not - after this change when you now were required to put them on W-2s - did that diminish the appeal for a lot of people, now that they did not have this option of going to you guys to work as independent contractors? Did that dry up your pool? Now they can go to anyplace and be a W-2 employee. Was there still something that you were offering?

G. Gentry: They were still getting paid by the hour.

NACCB Members' Contract for using IC's

Cassell: This was the great thing about the NACCB. We did not back off of using independent contractors. We started saying, "How can we continue to use independent contractors and do the best possible job of protecting ourselves?" One of the first things Harvey [Shulman] did was create the contract that we could use with the independent contractors and say, "If you use this, we can defend you if the IRS comes in after you; and you won't lose to the IRS."

Johnson: When you say "defend you," you are talking to the independent contractor?

Cassell: No, I'm talking about defend us as a company continuing to use independent contractors.

G. Gentry: We had a defense fund. Members contributed to the legal defense fund. It was not for all of the NACCB members, because it was voluntary, but you had to be a member to participate.

Johnson: Was it a full contract or was it just a section of the contract that you drafted?-

Shulman: There was a model contract written. Let's just say it was four pages, instead of the one-page thing that people were using before.

G. Gentry: The handshake.

NACCB's Legal Defense Fund and the IRS

Shulman: Out of the four pages there were sections highlighted that had to be used. They had to be used word-for-word in certain paragraphs. There were some paragraphs that companies could change. All NACCB members had the right to use this model contract. If a company wanted to join the legal defense fund: 1) it had to be an NACCB member; 2) it had to use this contract and for the sections that were highlighted it couldn't change any of that language; and 3) if it added anything else to the sections that were not highlighted, what it added could not be inconsistent with other things that were in there.

We also developed a bunch of operating procedures that we recommended. It was not as if you could use the contract and you could do everything else wrong. There were certain operating procedures. If a company agreed to do all the right contract stuff, then the company would pay

a certain amount of money each year to belong to the legal defense fund. It was a relatively small amount of money. It was a couple hundred dollars.

But what the company had to do was to pledge that if a fellow legal defense fund member got audited by the IRS, and if that member used the contract and did everything else right, the fund members would agree to pay up to \$10,000 per company per year to contribute to a high percentage of the legal costs of the company being audited. At its high point the legal defense fund might have had more than 100 companies in it. So we had pledges from NACCB members of over \$1 million a year that could be used towards paying the legal fees of companies being audited by the IRS.

What happened is that maybe 30 or 40 of our NACCB companies were audited by the IRS. A high percentage of those belonged to the legal defense fund; and we won these audits with the IRS. In a lot of cases, the companies had not been using the standard contract because they were being audited for prior years; but we still won the audits. When the contract was involved in the audit, we won those audits.

Companies started saying, "If you join NACCB and if you use their model contract and if you follow their operating procedures, you could survive these IRS audits." It was not exactly that simple; but I would say, more than anything, that saved the option of working as an independent contractor for people. The legal defense fund was not my idea. I think it was Tom O' Donohue's idea, out of New England.

When we would first go into these audits - I did most of the audits - and you talked to the IRS auditors, they would tell you all the companies they audited (that were not NACCB members) and how many workers they reclassified and that they were going to get you. Now all those things were shifting in the other direction.

G. Gentry: The IRS finally gave up auditing our type of company because they could not win. It was costing a lot of money to go after us; and there was no return on it.

Yost: Were there any antitrust concerns with developing a standard contract for a trade association?

Shulman: No, because the contract did not deal with any pricing issues; and it did not deal with exclusionary practices, or anything that remotely touched antitrust concerns.

Hahn: Was it just a matter of satisfying the 20 questions? [A copy of the IRS 20 questions as of that time period is shown at the conclusion of this transcript as Appendix A]

Shulman: No, it was a matter of not only using the 20 questions. I mean it is impossible to satisfy those. Nobody who is an independent contractor in any industry can satisfy all 20 questions, or even close to it. It was a matter of taking the reality, which is that some clients said, "We want the right to fire a worker at any time, without notice, for no reason." It is an indication that a person is an employee. But the clients always insisted that the staffing firms had to have the right to let a worker go at any time, without any notice. So we flunked that factor.

It was working with the factors that we could deal with. It was also making sure that, when companies used employees, they had a mirror image contract that was the reverse of an employment contract that said, "We can tell you where to work. We can tell you when to go to the bathroom." The goal was to distinguish - in writing - two very different ways of operating. So that even though two people might be working side by side for a company, one as an independent and one as an employee, if the IRS were to come in and look at how those people were controlled in terms of the documentation, they would see totally different documents.

Beyond the documentation we came up with certain operating procedures. If you used an independent, make sure the person did not just work in their name, "Mary Smith". At least it was as a DBA with an EIN, preferably as a corporation. Get a voided check from their business checking account that shows they actually have a business checking account and that the money is not going into their personal checking account. We would go through a bunch of operating procedures. It wasn't perfect but in the end it worked. Especially when you consider that 1706 is still around; and it is 20 years later.

Cassell: The failure of the NACCB is that Section 1706 is still on the books. The accomplishment is it has not made much difference; and that is primarily a result of the work that Harvey did in protecting us and winning those IRS audits.

Johnson: That brings up another question. Was there a need to have standardization in the contract on the other side, with your customers? Was there any need to provide some kind of standardization there to protect them from the same things?

Shulman: That was a problem for a couple of reasons. One reason was that in all these audits the IRS always looks for the weakest link. You could have a perfect contract with the independent contractor, great. They look at your operating procedures. Did you treat the person as an independent? Well, that's great. Then they start saying, "Let's see your contract with your customer."

Most of the times the customers had their own agreements; and the customer agreement would say things like, "Anyone you send to us must be your employee. We have the right as the customer to tell these people to do X, Y, and Z." They will be using the customer's equipment.

They will be responding to the customer's managers. So the customer contracts were like kryptonite to Superman. They really were. We developed a model customer contract which, of course, was impossible to get the large customers like Bank of America or Goldman Sachs, to use. .

Even with those contracts, what we had to do during the audits is - when the IRS would say, "I want to see your contracts with your customers" - we would say, "That is irrelevant." They would say, "If you told your customer the person is your employee and you gave the customer the right to direct these people, control them... that is a sign the person is your employee. We would say, "Since you are telling us that the fact that we signed a contract with the worker says the worker is an independent; and you tell us that it can say anything in writing. Whatever contract we sign with the customer, whatever it says, "Yes, that is our employee," well it really wasn't our employee and you can't use what we had in writing there against us. We would flip it against them.

So, yes, the customer contracts were a problem and continue to be a problem today. In fact, the customers are their own worst enemies because, even today, customers will put things in contracts that are totally unnecessary and that can only get them into trouble; but they're in the contracts.

Evans: So they can do the same contract for any kind of purchasing they ever do.

Johnson: Go back to your comment about the fact that 1706 hasn't made that much difference. You talked about the fact that you had to convert the ICs. Have you seen a change in the group of people that you were drawing on who want to be independent contractors? Are there more now? Are there less?

Evans: More.

G. Gentry: In the first major recession in the Bay Area, at the time we were watching this very carefully, we had a third of our member companies go bankrupt or go out of business. A third of the contractors either took employment or had to leave the area because they could not find employment. The billing rates dropped by a third and it took them roughly three years to start edging back up. For a very long time the contractors were willing to work for less because they just wanted a job. We were willing to work for less because we wanted the work. As I keep saying, in the 25 or 28 years I was in business, we went through three recessions and two depressions (in the Bay Area). That does not include the 2000 one, which was the worst.

Johnson: So the fluctuations really had nothing to do with 1706?

G. Gentry: It was the general economy.

NACCB's Role in the Taxpayer's Bill of Rights

Shulman: The reason that 1706 is still a danger is because the government - if it wanted, with creative lawyering on the government's part and with political muscle on the government's part - could do tremendous damage even today to companies that use independent contractors, because of 1706. The reason it has not happened is not just because we have good contracts and good operating practices, it is because there was a convergence of all that with a political climate that NACCB helped create in the late 1980s and early 1990s, when we took our experiences from IRS audits and the outrageous things that auditors were doing and testified before Congress.

We always said 1706 is unfair; but what we really said was, "Do you realize, under the guise of doing an employment tax audit, the outrageous things that government auditors are doing?" All of a sudden, people in Congress were aware. I mean the Taxpayer Bill of Rights which passed in 1989, or whenever it was, pieces of that came directly out of NACCB's experience and audits. It had nothing to do with changing 1706, but it created a climate that there was so much abuse going on by the government. And that built up with the National Federation of Independent Businesses and the Chamber of Commerce...

Evans: And now you are hearing that the IRS is starting to get active again in employment audits.

Shulman: I had not heard that.

Greenburg: I am sure there is a whole generation of those entrepreneurs that do not even know what 1706 is or NACCB. That was 20 years ago that we started. I'm sure these young whippersnappers don't know that.

Current Interpretation of 1706

Shulman: Also, what happened is that an overwhelming percentage of what we now call staffing firms would do business only with incorporated independent contractors. There is, in fact, a provision of the Internal Revenue Code that has a special rule about the employment status of individuals who are officers of their own corporation; and it is sort of this conflict in the Internal Revenue Code. You have these standards, the 20 common law questions for employment status and Section 1706. Then there is an entirely separate section of the code that says if someone is an officer of their own corporation, not an LLC or self proprietor; and your corporation has a contract to do business for a staffing firm or a customer, then under the

law you are an employee of your own corporation, not an employee of the staffing firm or the customer.

So we started developing a business practice - I do not know about Northern California now, but I would say in most parts of the country, certainly in New York and Washington, D.C. and Boston - probably 90 percent of the independent contractors used by staffing firms are incorporated entities. We now have this entirely separate argument that 1) we passed the common law test despite 1706; but 2) even if we do not pass a common law test, we have contracted with a corporation. Mary Jones is actually doing the work for her corporation as an officer of her corporation; and, therefore, she is an employee of her own corporation and not of anybody else. There are a lot of ways to get around it.

Johnson: Jon, I think you said you're incorporated.

Hahn: I am.

Johnson: The other people that you meet out there, is that pretty much the rule now these days?

Hahn: I had more contacts with other independent contractors a longer time ago, less so in the last seven or eight years; but then it was 50/50. Some were; some were not.

I did it for this contract I was on. It was required; and then it became advantageous for future work. Sun Microsystems was my last client that required it. I just lost them last December. Now I have to decide if I'm going to keep it or not. I still do some work through it; and there are some advantages to it. In California you have to pay \$800 a year tax whether or not you made money, and then have your taxes done, so I do not know. It is expensive here.

Greenburg: There is another practical reason before that. The IRS does not require you to issue a 1099 to a corporation. You were not issuing a 1099, so you were not raising the flag to the IRS that you were dealing with independent contractors.

Also, we had a state case, an unemployment case, a TSR Liabilities case. One of the arguments we made is - because the hearing officer had to determine whether an incorporated entity should be part of this unemployment audit - but we argued that it should be differentiated. We argued that, "The state has recognized this corporation as a viable entity. It pays its corporate taxes. You are asking the hearing officer to pierce the corporate veil for no reason." They bought it; and, basically, that is the law now in the state, that the only entities that are subject to unemployment law are unincorporated entities. Incorporated entities are outside scope.

G. Gentry: One of the things I observed during the last years I was in the business was that, in different parts of the country when NACCB members would convene and we would talk about, "How do you do this?" In some areas the agencies primarily used incorporated ICs (instead of W-2s). We would say, "Why?" And they would say, "We have to do that to get them." That was a competitive issue because they were competing with other agencies for top talent.

In other areas - and this was true of Northern California - the majority were hourly employees (W-2s) with some incorporated ICs. That may have shifted since. If it did, my guess is that it would be for competitive reasons. Some agencies were doing that so the other agencies had to start using more incorporated ICs.

Johnson: How about the Midwest, Jane?

Ross: After we joined the NACCB and found out what 1706 was doing, we went back and said, "You are either going to be incorporated or you will be an employee." I did not want to send 1099s out to anybody. I did not want red flags anywhere.

It took a little longer for that information to creep in from the coast, to get to the Midwest, about 1706. I was so glad that we had joined the NACCB and learned about it because it was a competitive advantage for us. We could go talk to our clients and tell them about what this was and how it wasn't going to really affect them. It was affecting us; and we were taking care of business, like we should. We had joined this organization that knew about it. We could talk to our contractors and explain to them what they had to do to protect themselves, and help protect us, also.

Shulman: That is an excellent point because, prior to 1706, workers were qualified by staffing firms basically in terms of their technical skills and the personality fit. What happened as a result of 1706 is you had to qualify somebody legally as an independent contractor.

Being an NACCB member became a real competitive advantage with customers. You could go to the customer and say, "If you don't want us to provide you any independent contractors, that is fine; you are the customer; and we will do whatever you want.

"If you are open to the idea, we belong to an association which has a standard contract. It has been through 30 IRS audits; and we actually do something that you do not find in a lot of places. We qualify the contractor, not just on technical and personality grounds; we qualify the contractor on legal grounds. We have not only the contract, but we have a checklist of things we get from them. Do they have a business account, et cetera?" It really became a selling point for customers that were still willing to use independent contractors.

Johnson: I'm going to go back to something you were saying earlier. The customer wanting to have this very tight control over how the person was operating is one of the subjects that were on this list, the whole concept of monitoring the work that people do. I believe one of the things on that checklist is that the person is functioning very independently, or without somebody looking over their shoulder supervision.

How did that all fit together? How did you make all that work? If you had customers who really wanted to supervise and, at the same time, contractors who wanted to be qualified as an independent contractor, plus the fact that people who wanted to be independent contractors do not generally like somebody looking over their shoulder all the time, how did all that fit together?

Shulman: We focused on the things that were not under customer control. In terms of the work that was being done, the customer says, "Here are the technical specifications." We would say, "When an architect designs a house and you hire a contractor to build it, you do not say that the contractor is your employee because they are following the architectural plans."

We would say things like, "The customer cannot tell this person whether they could have another job or not. The customer – and, again, it depends on the customer - the customer does not make this person come to staff meetings. The customer does not provide the person with training." We would look at the different elements of the working relationship, apart from the substance of the work, and say, "There is a big difference here. Employees are subject to control in all of these different ways; and independent contractors are not." They would say, "You are just trying to get around the test."

I think I am proudest of how NACCB brought this whole issue to the debate, going beyond independent contractors. We said, "We have a knowledge-based economy; and you are trying to apply a test of employment that was created in medieval England in 1419. That is not the way it works. The common law test has to change with time. When you are applying it to knowledge workers, you cannot say that because the person is working on the customer's premises, that is a sign of employment. That is simply where the network is."

This was before the remote stuff. So we really changed the nature of the debate from the technicalities of the test to what kind of world do we live in and what type of workers are we dealing with? As a result of all the political pressure going on by us and other industries and the congressional hearings in the 1990s, the IRS in 1996 came out with a 100-page training manual for all of its auditors saying, "Here is what you look for in an independent contractor audit."

We were given a draft of that training manual; and we critiqued it and criticized a lot of the provisions in it. It used to say, for example, if you were paid by the hour that is a sign that you are an employee. We would say, "Lawyers are paid by the hour. Accountants are paid by the hour. We're the same kind of knowledge worker." In the final version of the manual it says,

“The fact that somebody is paid by the hour is not a sign of employment if it is customary in the industry to pay both employees and independent contractors by the hour.”

A lot of things in that manual specifically say, “The common law test has to be applied with due regard for the fact that we are now going into the 21st Century.” A lot of things in the common law test that previously had been used against us now became neutral factors in the manual. The IRS would say, “The fact that you are working on somebody’s premises is sort of irrelevant. The fact that you are using their equipment is irrelevant if that is where the work has to be done for security or logistical or other purposes.”

So I think the debate about all these issues has changed quite a bit from the very narrow sort of technical analysis of, “Are you meeting these common law factors the way people looked at them even in the early 1980s, let alone in the 1400s.”

Educating Congress about the Knowledge-Based Economy

G. Gentry: A lot of education was going on. One of the functions that NACCB, and particularly Harvey, filled was educating the IRS, legislators, America, independent contractors, clients, etc., that it is different.

Shulman: It is really not me. Grace and Dave and Randy and all these folks, we would go into meetings with members of Congress. You have got to understand this all tied into the chapter nature of NACCB and the local presence. They would go in and say, “We are in your district” or “We are in your state, and we have a \$10 million company - or \$40 million or \$100 million or whatever it was - and we are not doing landscaping, construction, or janitorial services. When you think of independent contractors, we are not sending people out on these assignments who are lower paid, lower educated, and lower skilled.

“In fact, we would love to have everybody work as our employees because we make more money that way. We would love to make more money; but in fact, the workers want to be independent. They are independent. These are jobs being created in your state. Why would you want to tell a worker who is bright and well paid and skilled, ‘No, you can’t be self employed’?”

The members of Congress would look at us; and it was like a light bulb went off to the point that it really was sort of amazing. We got the Congressional Black Caucus to write a letter to Senator Moynihan asking for the repeal of 1706 because 1706 was a law that discriminated against minorities and women.

Johnson: What is the date on that?

Shulman: This was 1992. We totally changed what the debate was about; from this narrow issue that NTSA and ADAPSO [Association of Data Processing Services Organizations] had made it, to 21st Century knowledge workers. What are you doing to entrepreneurs? As Dan said, this industry has a sort of low barrier to entry. A black man or any woman, who wanted to be self employed and had any brains, could go out and work as an independent contractor if they were willing to take the risk.

Now Congress was saying, out of all the industries in the country, "You, Miss so and so or Mister African American, if you want to be a hairdresser or you want to be a janitor or you want to be anything else except a computer programmer, the laws will let you do that; but the laws do not want you to be a self employed technical worker." We would tell that to Dianne Feinstein or whomever and what could they say?

In 1998, on the New York Times' Business Section, first page: "How a tax law helps ensure a scarcity of programmers." This is eleven years after 1706 was passed. It is about Midge Johnson, a black woman in the Washington, D.C., suburbs. She was told that, because of 1706, lots of people would hire her as an employee; but if she wanted to be a self-employed person, nobody was willing to give her a job. That is what was going on. We built something because the business owners were able to go in and talk to their members of Congress and other organizations.

And whereas, historically, employers and employees are always knocking heads, NACCB had a coalition of associations working together on 1706 repeal. That included the American Consulting Engineers Council, the Independent Computer Consultants Association, the IEEE, the National Society of Professional Engineers, and the Technical Consultants' National Association. We eventually even got the Black Data Processing Association.

When we were taking this issue up in Congress, it was not that the company owners, the bad employers, were coming in and saying we want to change the law. We had all of these worker groups saying, "This law screws us."

G. Gentry: That is how we got that overtime issue passed.

Cassell: You know the interesting thing about this is - what difference does it make? Think of all the time and money that was spent. What difference does it make if somebody is an independent or an employee?

Greenburg: The issue is collection of taxes, and it was proved that our industry, independents, have a better record in paying their taxes.

Johnson: Is the IRS still doing these kinds of audits now, to look for this?

Hahn: Randy just said they are coming alive again.

Evans: Yes, they are coming back.

Johnson: All the issues I have heard about in recent years have been cases where a person, an individual who was an independent contractor, decides they should have been treated as an employee; and they are into shading things.

Evans: I think things have come full circle. I continue to use Exxon as an example. In 1988 they required everybody to be W-2. Today they don't even ask. There are a lot of people who are now contracting at Exxon, who are 1099; and Exxon does not even bother asking anymore.

Greenburg: They don't know about the law. Once again, it is another generation of managers that are unaware of it.

G. Gentry: Also, there will be some hot, young IRS agents who want to make their marks by collecting a lot of back taxes, so they will go after them.

1706 and IRS Still a Threat to Contracting Companies

Shulman: I would say in the last few years there has been a lot less IRS activity on a national level. There have been geographic pockets. From five years ago to two years ago this issue was really hot in New York. The IRS in New York had a team of people that went after IT staffing firms in New York that used independent contractors. There are a couple of other places around the country where that happened, but there is very little of that going on now.

I think it is going to come back because there is a tax gap now. Just last week, if you read the newspaper or at least the boring tax publications that tax lawyers read, there was a congressional hearing in which the members of Congress had brought in all these labor people who said, "We would be able to eliminate the budget deficit if companies were not allowed to use independent contractors because people are not paying taxes."

G. Gentry: They want you to belong to a union.

Shulman: The members of Congress were saying, "Yes, we have got to start looking at that." The IRS commissioner has said that he is going to start looking at independent contractors.

Evans: And they just created a small business audit unit to go after and increase the number of small business audits.

Shulman: So I think it is going to come back.

Williams: They are afraid to go after the business owners who have illegal immigrants. They never get their hands slapped with all the taxes they do not get collected there.

Hahn: Let me just make a point about current companies. Two of my clients from the last couple of years have third party companies that vet their independent contractors. All the billing goes through those third party companies. That is one of the ways that they protect themselves. The deal is that they are supposed to be protected from these employment issues by doing that.

Cassell: Theoretically, though, the argument goes, "Who are you an employee of?" That is why I am saying that the whole thing is ridiculous. Everybody is doing the same work. What difference does it make? But there are a lot of jobs created by keeping this whole thing alive.

Payment Practices in the Industry

Johnson: We have got about 15 more minutes here; and I want to go to something else on this list that really intrigues me, about the different ways of paying the contractors. What different practices were there, in terms of paying the contractor on a regular scheduled basis or whether you paid them when you got paid by the customer? What were some of the different practices in terms of how you reimbursed the contractors?

Cassell: The contract said that the independent contractor got paid when we got paid, but there was an amendment to the contract that said, "We will advance you this pay for two weeks; but if the customer doesn't pay, we have the right to go back and collect this from you."

By the way, there were times when the customer did not pay; and how many of us ever went back to try to collect it from the independent contractors?

Hahn: I have got to say that everything I have heard out of this group - you guys are much more benevolent than the agencies that I went through.

G. Gentry: You did not come to NACCB.

Hahn: I did not. Those were my experiences. I got delayed pay because of problems that were not mine. In one case, the agency went out of business and took my funds with them.

Cassell: With one client, the client went out of business owing us \$600,000. We never went back and collected any of that from our contractors.

G. Gentry: Yes, we almost went bankrupt because we had a client that got into us for \$400,000; but we paid every contractor every penny that we owed them.

Hahn: You guys are angels.

Johnson: So in your contractual agreement you protected yourself by saying that they got paid when you got paid; but in actual practice they got paid.

Ross: We paid when our clients paid us unless they would come to us and say, "We are having a financial hardship. It has been five weeks since I got a check; and it is not my fault." Then we would check with the client, and the client just says to us, "It is just paperwork. We just have not gotten the paperwork through yet. They are getting a check. Do not worry about it." We would then pay them a part of what they were owed, not all of it, but a part of it at least, to give them some money.

G. Gentry: I think different companies did it different ways in different areas at different times. Initially we paid people when we got paid; and our clients were just wonderful about making sure that we got paid because they understood that was how we were working. As other companies started doing it every two weeks, as a competitive issue we started doing that. Then when 1706 happened and one of the tests was pay when you got paid, so it changed at different times. It worked different ways.

Williams: We did not do the "pay when you got paid." We had to pay on time, regardless of the client payments.

Shulman: When you say the contract said this but this is the way it was really done, actually, the NACCB model contract specifically says that you get paid when we get paid, but we are willing to - and it is right in there- we are willing to pay you before we get paid. If we do not get paid, we can demand a refund of the money and you are obligated to refund it.

In fact, other than your unusual client situations, most ICs were willing to live with that because 99 percent of the time the client pays and the worker gets paid. In the real world, the chance you are not going to get paid is very small. When it would happen, I would say to them, "Have you cut a check to the IC yet? Okay, don't cut that check. If you cut the check to the IC, bring a lawsuit or at least write a letter threatening to get the money back because then we would be able to show to the IRS auditors that we were not guaranteeing payment."

So one independent contractor out of 500 might suffer; but that is because the other 499 were going to benefit by the fact that this independent contractor did not get his or her \$1,900 in payment.

Evans: In all fairness, unless the customer was having financial problems, the only reason that you did not get paid was because the customer was not satisfied with the work of the IC. It is a little bit easier to go to the IC and say, "This is the reason why." I am not saying they are always happy to hear that; but it does make it a little easier to sell them on the concept that you are at risk here.

Ross: I think most of them who did not do a good job knew they did not do a good job.

G. Gentry: We paid the ICs anyway; but we had a policy that if the customer was not satisfied with the work, if they registered a complaint with us before the third week and then, by the sixth week, told us that it just was not working, we did not bill the customer. That was just one of our satisfaction guaranteed policies.

Cassell: The other thing is that most of us had a protection before we would pay anybody, and this included hourly workers. You had to get a signature from the client on your timesheet that said "Yes, these are the hours that you worked, and this is what you did." Without that, we were not obligated to pay.

Competition from ICs Who Worked for a NACCB Member

Johnson: We talked earlier - in the other meeting - about your contracts with the contractors about their working directly with your clients. What was said was that it did happen, but sometimes it was not worth pursuing? Is that it?

Cassell: Very rarely did that happen.

G. Gentry: It depended. I remember one guy who went around to the other side, worked directly with the client. The client sided with him. Then he left that client prior to completing the project for the client. Of course, that made me go, "Ha, ha, ha, ha!" He then started his own agency and later applied for membership with the Northern California Chapter of NACCB - and gave me as a reference! When they called me, I said, "You are kidding! That crook? No!" Apparently he completely erased this from his memory. I did not, however, forget.

Cassell: And he - to this day - is not a member of the Northern California Chapter?

G. Gentry: No, later they (NACCB) changed the policy so that, basically, if you could write a check, you could join.

Ross: But isn't there a member in New England that did exactly that? He was an employee of one of our members and left and started his own company and went back into that client's company?

Williams: When people that did that to us, we did not lay low. We pursued them. We figured those are our contracts. In our case, it happened often enough, that they would go to a competitor and would sweet talk them for a couple dollars more. There was no risk on that other person (the client); but we would definitely pursue the contractor. Why not? We thought if you laid down, everybody is watching. You will be knocked down again and again and again. If you do not stand up and fight, everybody will know that you do not protect yourself.

G. Gentry: Yes, I could see that point. To us it happened very rarely. The interesting thing that I observed is every time it happened, the same contractor later ended up screwing the client, first us and then the client. I thought, "Well, there is a pattern here. You would think the clients would figure that out."

Johnson: Is there anything else that you guys think that we ought to cover in terms of the relationships with the contractors? That is what this session was really all about. Is there anything else?

Providing Training to Contractors

G. Gentry: I think there was one interesting phase. Remember when it became very popular - as a competitive issue - for companies to offer training to contractors? There was just a little period during which that became a very popular thing to do, at least in Northern California. Did this occur anywhere else?

Williams: Yes, we did it as a way to recruit...

G. Gentry: It was during one of the times when everything was booming. It was really hard to find good contractors. So, as a competitive edge - it always starts as a competitive edge and then it becomes the cost of staying in business - all of us offered training in a variety of ways.

I think some of it was videotape training. Some of it was reimbursing their tuition to attend different types of training. This was while they were working often on another project; but the idea was that they could upgrade their skills and then we would place them into a job with their

new skills. There were presentations at the NACCB Conference about companies who had done that and how successful they had been.

I remember one company especially. They would provide the training; and then they would take the contractor into a client and say, "This is the first time they have used these skills, so we will not charge you as much because they are going to develop this expertise. Then they will be a more valuable contractor." It was a competitive issue; and I thought it served everybody well. Customers got a motivated contractor. The contractor got to upgrade his or her skills. Agencies got to look benevolent. Hey, it is a marketing issue!

NACCB's Code of Ethics & Self-policing of the Industry

Ross: The other thing that NACCB developed - I think was one of Grace's pet things she wanted to get done - was the code of ethics or code of business practice. I call it the code of ethics. That - to me - was something that all of the companies in the organization adopted. We put it on all of our materials, whether it went to the contractor or the client.

I think that was a terrific thing that we did as an organization, to show contractors and clients that we did operate with good business practices; and we had a good code of ethics. It said, "We are not going to cheat you. We are not going to pull people out of your company to become contractors for us. We will share information with you." I do not remember all of the points that there were; but I think that was something that was beneficial.

G. Gentry: One of the things we did, we went and educated the clients. We said, "This is the code by which NACCCB members are abiding. If you are using agencies that do not belong to NACCB, you should insist that they abide by them as well." We found that, often, it leveled the playing field because some of the things we were doing were actually more expensive for us to do it that way. The clients then would make demands on non-NACCB agencies to behave according to the same behavior.

Johnson: Do you think establishing that culture where there was a code of ethics operating helped prevent some of the cases where a contractor might go to your client and try to steal the business, because there was client awareness.

G. Gentry: Yes, the client then saw us as a collaborator. I always said to all of my salespeople, "What you want to do is not sit across the table from the client. You want to sit beside the client and say, "Let us solve your problem." We are a team working with a client.

Yost: Were NACCB members ever kicked out of the organization for breaking the code of ethics?

G. Gentry: They were in Northern California. Three offenses and you were out. The first two offenses you were fined. We had two members that left after their first two offenses because they did not want it to be known in the community that they had been kicked out. They knew they were going to offend a third time.

Greenburg: I was curious what other companies had done, especially in the late 1990s when it was really important to recruit good consultants. We actually developed a position of the Vice President of Consultant Services. Her entire job was to make sure the consultants were happy. She would visit them. She would take them to lunch. She would know their birthdays. That was her entire job. She was in charge of morale for the consultants; and it worked very well.

G. Gentry: I know other companies did that. We had a woman; that was her full time job. We called her "The Contractors' Mom."

Cassell: You were treating them like employees.

Johnson: They were treating them like suppliers really. You do that with your good suppliers.

Greenburg: Exactly.

G. Gentry: She sent them birthday cards, called them on a regular basis, saw if they were happy, started working with them in advance so we could start looking for another job to transition them readily from job A to job B, et cetera. Yes, the contractors' mom.

Recruitment of Foreign Labor

Shulman: Luanne, I think one thing you asked about that affected the treatment of independent contractors. As important as 1706 was - and clearly that was a watershed - probably the use of H1B labor and the availability of the large number of foreign workers to work in the IT industry had a tremendous impact on the use of independent contractors.

The reality is, at some point, the laws crumble. The reason that the Soviet Union fell apart is, ultimately, communism just was not an economic way that was going to survive of its own natural forces. It is really the same thing. The natural order in this industry is a mix of people. People who want to be independent can be independent; people who want to be employed, who want benefits, aren't independent. You can't really start monkeying with the supply and demand thing.

Had there not been an influx of foreign labor and had customers not been so desperate to want the people with the right skills at the right time, we probably could have sent them anyone. They needed the work done. But when foreign labor increased, as you know, from 65,000 to 120,000 and then to 300,000, it really shifted the dynamics of the independent contractor issue. It never was a one-for-one tradeoff. It is not that a customer said, "Well, I have an H1B worker so I am not going to use an independent contractor."

I think everyone here will tell you when the customers want the labor, the lawyers come in second place. The business people and the technical people come in first place. What happens is that the business people and technical people tell the lawyers, "Find a way to make this happen with minimal risk to us; but it has to happen." I think the whole foreign labor issue really changed that place.

Williams: Maybe you covered it while I was out, but there was such a shortage there in the middle 1990s to the late 1990s that we ended up with recruiting outposts in Sydney, Cape Town, London, Toronto and Mexico City. We had a great international recruiting program; and we pretty much had immigration lawyers on staff. It was exciting. We all got educated too about the rest of the world. All those folks offshore are in the country now; and you don't have to buy those \$10,000 relocation packages. We are doing business in India right now.

Evans: One item that has not been talked about very much today - and I do not know where it fits in, if at all - is the NACCB's involvement in the overtime issue.

Johnson: Unfortunately, I am not going to be able to be here tomorrow; but I think that is one of the things that Burt Grad plans for the final wrap-up session.

G. Gentry: The final plenary session?

Johnson: Yes.

G. Gentry: Everybody, tonight when you go back to your hotel room, think of the things that we did not cover today. Look at the sessions that are going to happen tomorrow morning, first in the group sessions. If it does not fit in those, make a note because when we come back for that final plenary session that is going to be our last chance to get it on record. Unless later you are willing to write notes and do your biography and send it in and put it on the website, as they were encouraging you to do earlier. For NACCB we would like to get this all into this record.

Shulman: Yes, that is exactly what Burt intends to do. We left off at the Univac computer; and there is this whole other thing that, in many ways, is much, much more important.

Johnson: Yes, he plans a continuation of NACCB history tomorrow. We really wanted to focus today on 1706 and the structure of the businesses that were involved in that.

Shulman: Jeff, do you feel as a listener today and a questioner that what you got from the participants here is new and useful? What is your reaction to what went on today?

Yost: I think it has been useful. As you said, exploring issues after 1706 and how the organization evolved, that has been touched upon; but the breadth of the organization, the different mechanisms at use, the different issues it focused on, the different lobbying efforts. All those things could be explored more fully.

Shulman: We need to come on strong tomorrow.

Johnson: It is hard to know. Our policy is, you just gather whatever you can, because you do not know how a historian 50 years from now may take this information and will say, "Look, there is the beginning of this trend that has culminated in the way everybody works now, 50 years later." It is hard to know how relevant it is going to be to somebody in the future. As Jeff was saying, he goes back and looks at stuff that happened 50 years ago; and he can just see exactly how things evolved.

G. Gentry: See the arc.

Evans: I think it could be argued that the NACCB has not been that much of a participant, for example, in the off-shoring that is going on- and that has had a big impact on our industry.

NACCB vs. ADAPSO

Williams: The trend I thought I saw was the beginning of NACCB. There were the other adversary organizations, one was ADAPSO; but as NACCB grew, it grew larger and larger than ADAPSO. I used to attend a bunch of those ADAPSO sessions years ago; but those people started coming to the NACCB because this was an IT services group and not a catch all for software rights in Brazil and stuff like that. ADAPSO shrank; and NACCB grew. I used to see these people from ADAPSO who came over to the NACCB - to the NACCB's credit.

G. Gentry: Everybody says we have great conferences.

Evans: How big was NACCB at the peak?

G. Gentry: 450 to 500 member companies.

Shulman: For ADAPSO, really the relevant comparison is to their IT services or the professional services division, which at its peak had 100 members.

Johnson: Something like that. The real competition with ADAPSO was the NACCB regional associations. When I joined ADAPSO in the 1970s, it was the only place to go to talk to other people who were trying to figure out how you run a software products company. But by the time I was the executive director there, one of the issues that everybody was pushing was "We ought to try to go out and compete against the regional associations, recruit these small companies to come to ADAPSO again".

Well, why would they? They could go to NACCB Chapter meetings. They could get the same thing, the same networking, by going to a breakfast meeting or a dinner meeting; and they did not have to incur the expenses of being gone for three days to go to a conference. What I ended up doing was selling ADAPSO on the fact that they should establish affiliations with these regional associations.

So we started bringing those groups together at the ADAPSO conferences, with representative from those groups. That has now turned into the organization called CRITA, which is the Council of Regional Information Technology Associations. They have got something like 70 regional association members. It has turned into a big organization; and ADAPSO or ITAA really can't compete on that level with the people going primarily for networking and information.

Shulman: Because it is local and regional based and sort of going back to the chapter basis of what NACCB tried to do.

Johnson: Yes.

Williams: Well you must remember Jack Courtney. It was so surprising to see him showing up at NACCB meetings.

Johnson: He did?

Williams: Many times. This was many years after he was testifying before Congress.

Johnson: Thank you. This is the close of this session.

Appendix A: Independent Contractor Test

EMPLOYMENT STATUS - A COMPARATIVE APPROACH

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| <p>Under the common law test, a worker is an employee if the purchaser of that worker's service has the right to direct or control the worker, both as to the final results and as to the details of when, where, and how the work is done. Control need not actually be exercised; rather, if the service recipient has the right to control, employment may be shown.</p> | <p>Depending upon the type of business and the services performed, not all of the twenty common law factors may apply. In addition, the weight assigned to a specific factor may vary depending upon the facts of the case. If an employment relationship exists, it does not matter that the employee is called something different, such as: agent, contract labor, subcontractor, or independent contractor.</p> |
| <p>1. INSTRUCTIONS:</p> | <p>11. ORAL OR WRITTEN REPORTS:</p> |
| <p>An Employee receives instructions about when, where and how the work is to be performed.</p> <p><i>An Independent Contractor does the job his or her own way with few, if any, instructions as to the details or methods of the work.</i></p> | <p>An Employee may be required to submit regular oral or written reports about the work in progress.</p> <p><i>An Independent Contractor is usually not required to submit regular oral or written reports about the work in progress.</i></p> |
| <p>2. TRAINING:</p> | <p>12. PAYMENT BY THE HOUR, WEEK, OR MONTH:</p> |
| <p>Employees are often trained by a more experienced employee or are required to attend meetings or take training courses.</p> <p><i>An Independent Contractor uses his or her own methods and thus need not receive training from the purchaser of those services.</i></p> | <p>An Employee is typically paid by the employer in regular amounts at stated intervals, such as by the hour or week.</p> <p><i>An Independent Contractor is normally paid by the job, either a negotiated flat rate or upon submission of a bid.</i></p> |
| <p>3. INTEGRATION:</p> | <p>13. PAYMENT OF BUSINESS & TRAVEL EXPENSE:</p> |
| <p>Services of an Employee are usually merged into the firm's overall operation; the firm's success depends on those Employee services.</p> <p><i>An Independent Contractor's services are usually separate from the client's business and are not integrated or merged into it.</i></p> | <p>An Employee's business and travel expenses are either paid directly or reimbursed by the employer.</p> <p><i>Independent Contractors normally pay all of their own business and travel expenses without reimbursement.</i></p> |
| <p>4. SERVICES RENDERED PERSONALLY:</p> | <p>14. FURNISHING TOOLS & EQUIPMENT:</p> |
| <p>An Employee's services must be rendered personally; Employees do not hire their own substitutes or delegate work to them.</p> <p><i>A true Independent Contractor is able to assign another to do the job in his or her place and need not perform services personally.</i></p> | <p>Employees are furnished all necessary tools, materials, and equipment by their employer.</p> <p><i>An Independent Contractor ordinarily provides all of the tools and equipment necessary to complete the job.</i></p> |

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| 5. HIRING, SUPERVISING & PAYING HELPERS: | 15. SIGNIFICANT INVESTMENT: |
| <p>An Employee may act as a foreman for the employer but, if so, helpers are paid with the employer's funds.</p> <p><i>Independent Contractors select, hire, pay, and supervise any helpers used and are responsible for the results of the helpers' labor.</i></p> | <p>An Employee generally has little or no investment in the business. Instead, an Employee is economically dependent on the employer.</p> <p><i>True Independent Contractors usually have a substantial financial investment in their independent business.</i></p> |
| 6. CONTINUING RELATIONSHIP: | 16. REALIZE PROFIT OR LOSS: |
| <p>An Employee often continues to work for the same employer month after month or year after year.</p> <p><i>An Independent Contractor is usually hired to do one job of limited or indefinite duration and has no expectation of continuing work.</i></p> | <p>An Employee does not ordinarily realize a profit or loss in the business. Rather, Employees are paid for services rendered.</p> <p><i>An Independent Contractor can either realize a profit or suffer a loss depending on the management of expenses and revenues.</i></p> |
| 7. SET HOURS OF WORK: | 17. WORKING FOR MORE THAN ONE FIRM AT A TIME: |
| <p>An Employee may work "on call" or during hours and days as set by the employer.</p> <p><i>A true Independent Contractor is the master of his or her own time and works the days and hours he or she chooses.</i></p> | <p>An Employee ordinarily works for one employer at a time and may be prohibited from joining a competitor.</p> <p><i>An Independent Contractor often works for more than one client or firm at the same time and is not subject to a non-competition rule.</i></p> |
| 8. FULL TIME REQUIRED: | 18. MAKING SERVICE AVAILABLE TO THE PUBLIC: |
| <p>An Employee ordinarily devotes full-time service to the employer, or the employer may have a priority on the Employee's time.</p> <p><i>A true Independent Contractor cannot be required to devote full-time service to one firm exclusively.</i></p> | <p>An Employee does not make his or her services available to the public except through the employer's company.</p> <p><i>An Independent Contractor may advertise, carry business cards, hang out a shingle, or hold a separate business license.</i></p> |
| 9. LOCATION WHERE SERVICES PERFORMED: | 19. RIGHT TO DISCHARGE WITHOUT LIABILITY: |
| <p>Employment is indicated if the employer has the right to mandate where services are performed.</p> <p><i>Independent Contractors ordinarily work where they choose. The workplace may be away from the client's premises.</i></p> | <p>An Employee can be discharged at any time without liability on the employer's part.</p> <p><i>If the work meets the contract terms, an Independent Contractor cannot be fired without liability for breach of contract.</i></p> |
| 10. ORDER OR SEQUENCE SET: | 20. RIGHT TO QUIT WITHOUT LIABILITY: |
| <p>An Employee performs services in the order or sequence set by the employer. This shows control by the employer.</p> <p><i>A true Independent Contractor is concerned only with the finished product and sets his or her own order or sequence of work.</i></p> | <p>An Employee may quit work at any time without liability on the Employer's part.</p> <p><i>An Independent Contractor is legally responsible for job completion and, on quitting, becomes liable for breach of contract.</i></p> |