

TAKING THE EMPLOYER OUT OF EMPLOYMENT LAW?
ACCOUNTABILITY FOR WAGE AND HOUR VIOLATIONS IN AN
AGE OF ENTERPRISE DISAGGREGATION

BY
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I.	INTRODUCTION	
II.	ENTERPRISE DISAGGREGATION IN THE MODERN ERA	
	A. <i>The Decision to Make It Yourself or Buy It from Someone Else</i>	
	B. <i>The Law's Role in the Shift from Integration to Disaggregation</i>	
	C. <i>Racing to Outsource, Racing to the Bottom</i>	
III.	EXISTING AND PROPOSED RESPONSES TO DISAGGREGATION AND NONCOMPLIANCE	
	A. <i>Expanding the Definition of "Employer"</i>	
	B. <i>Existing and Proposed Extensions Beyond the "Employer"</i>	
IV.	A WAY FORWARD? TAKING THE "EMPLOYER" OUT OF WAGE AND HOUR LAWS	
V.	CONCLUSION	

I. INTRODUCTION

The International Labor Organization's conception of "decent work" embodies within it a number of goals, including assuring that workers receive a living wage.¹ While the compensation mandated by this country's

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1. International Labor Organization [ILO] Director-General, *Report of the Director-General: Decent Work* (June 1999), available at <<http://www.ilo.org/public/english/standards/relm/ilc/ilc87/rep-i.htm>> ("The goal is not just the creation of jobs, but the creation of jobs of acceptable quality. The quantity of employment cannot be divorced from its quality. All societies have a notion of decent work, but the quality of employment can mean many things. It could relate to different forms of work, and also to different conditions of work, as well as feelings of value and satisfaction. The need today is to devise social and economic systems which ensure basic security and employment while remaining capable of adaptation to rapidly changing circumstances in a highly competitive global market."); Int'l Labour Conference, Declaration on Social Justice for a Fair Globalization, ILO 9-10 (June 10, 2008)

wage and hour laws falls far short of this aspiration,² enforcing these laws is, as a practical matter, the starting point. Decent work is unattainable for those who toil at the low end of the labor market unless they have a meaningful guarantee of minimum compensation.³ Yet this protection demands more than establishing wage standards; it requires maintaining social and legal systems that promote effective enforcement.⁴ In a post-recessionary America, ensuring such enforcement, even of existing mandates, will be a significant challenge.

The Fair Labor Standards Act (FLSA), supplemented and sometimes enhanced by state law, provides minimum wage and overtime protections.⁵ But even before the economic downturn, violations of these and other basic legal protections for workers were widespread.⁶ The Great Recession now

[hereinafter Declaration on Social Justice], available at <http://www.ilo.org/wcmsp5/groups/public/---dgreports/---cabinet/documents/publication/wcms_099766.pdf>, (declaring as a commitment of the ILO to promote and enhance “policies in regard to wages and earnings, hours and other conditions of work, designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed and in need of such protection”).

2. Cynthia Estlund, *Who Mops the Floors at the Fortune 500? Corporate Self-Regulation and the Low-Wage Workplace*, 12 LEWIS & CLARK L. REV. 671, 678-79 (2008) (discussing how minimum labor standards alone are insufficient to ensure decent work).

3. Cf. INT’L LABOUR ORG., GLOBAL WAGE REPORT 2008/09, MINIMUM WAGES AND COLLECTIVE BARGAINING: TOWARDS POLICY COHERENCE 47-53 (2008), available at <http://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/@publ/documents/publication/wcms_097013.pdf> (discussing the role of minimum wage laws and enforcement in helping to ensure decent wages).

4. Estlund, *supra* note 2, at 679.

5. The FLSA requires covered employers to pay covered employees a minimum wage, currently \$7.25 for most employees. It also requires employers to pay workers an overtime premium at one half their “regular rate of pay” for hours worked in excess of forty hours per week. See 29 U.S.C. §§ 206(a)-(b), 207(a)(1) (2006 & Supp. III 2009). Many states have their own minimum wage and overtime protections, although their coverage and protections vary greatly. See *Minimum Wage Laws in the States – January 1, 2011*, U.S. DEP’T OF LABOR, <www.dol.gov/esa/minwage/america.htm> (last revised Dec. 2010) (listing state minimum wage and overtime protections). As of January 1, 2011, five states have no minimum wage and four states have minimum wage requirements that are lower than the federal minimum (which provide the floor for only those workers falling outside of the FLSA’s coverage). See *id.* Approximately half of the states track the federal mandate, although their coverage may be broader. Seventeen states and the District of Columbia have passed higher minimum wage requirements. See *id.* Some municipalities also regulate wages; for example, San Francisco’s current mandate is \$9.79. See *Minimum Wage Ordinance (MWO)*, CITY & CNTY. OF SAN FRANCISCO LABOR STANDARDS ENFORCEMENT, <<http://www.sfgsa.org/index.aspx?page=411>> (last viewed Mar. 15, 2011). A number of cities also have enacted “living wage” laws governing municipal contractors. See generally Scott L. Cummings & Steven A. Boutcher, *Mobilizing Local Government Law for Low-Wage Workers*, 1 U. CHI. LEGAL F. 187 (2009); Clayton P. Gillette, *Local Redistribution, Living Wage Ordinances, and Judicial Intervention*, 101 NW. U. L. REV. 1057 (2007). In addition, many states have wage payment laws (including so-called “theft of service” statutes) that provide for civil and criminal liability for failure to pay promised wages. See, e.g., Rita J. Verga, *An Advocate’s Toolkit: Using Criminal “Theft of Service” Laws to Enforce Workers’ Right to Be Paid*, 8 N.Y. CITY L. REV. 283 (2005).

6. See, e.g., ANNETTE BERNHARDT ET AL., BROKEN LAWS, UNPROTECTED WORKERS, VIOLATIONS OF EMPLOYMENT AND LABOR LAWS IN AMERICAN CITIES 5 (2009) [hereinafter BROKEN LAWS], available at <http://nelp.3cdn.net/319982941a5496c741_9qm6b92kg.pdf>; Annette Bernhardt et al., *An Introduction to the “Gloves-off Economy”*, in THE GLOVES-OFF ECONOMY: WORKPLACE

has spawned additional growth of the low-wage sector,⁷ putting more workers at risk and increasing the burden on already over-extended regulators. As the American economy begins to grow again, competitive capital and product markets will continue to exert significant pressure on firms to keep labor costs down, ensuring powerful incentives to skirt wage and hour requirements.⁸

Noncompliance with wage and hour mandates at the low end of the market is due in large part to enforcement problems. These include insufficient public oversight, the absence of unions, and a host of factors that limit the effectiveness of private enforcement.⁹ Contributing to these phenomena is the disaggregation of business enterprises into smaller, independent parts. Once limited to the margins, these kinds of structures now are a part of most large enterprises, capturing many millions of workers.¹⁰ And there is evidence that the recession has accelerated this trend.¹¹

Although there are other, efficiency-enhancing reasons for end-user firms to outsource services and production, limitations on liability for work-law violations invite these arrangements.¹² Statutory protections for workers, including wage and hour laws, impose duties only on “employers,” which, despite variation in the underlying tests, ultimately hinges on how much control a firm exercises over the work.¹³ Thus, in

STANDARDS AT THE BOTTOM OF THE LABOR MARKET 1, 3, 7-8, 11 (Annette Bernhardt et al. eds., 2008) [hereinafter Bernhardt et al., *Introduction*] (discussing various studies regarding the prevalence of violations of wage and hour laws, labor laws, and workplace health and safety requirements); Brishen Rogers, *Toward Third-Party Liability for Wage Theft*, 31 BERKELEY J. EMP. & LAB. L. 1, 10 n.33 (2010) (citing numerous studies finding widespread violations); Catherine K. Ruckelshaus, *Labor's Wage War*, 35 FORDHAM URB. L.J. 373, 389-90 (2008) (same); David Weil, *Public Enforcement/Private Monitoring: Evaluating a New Approach to Regulating the Minimum Wage*, 58 INDUS. & LAB. REL. REV. 238, 246-47 (2005) (discussing violations in the garment industry).

7. See, e.g., Michael Luo, *New Job Means Lower Wages for Many*, N.Y. TIMES, Sept. 1, 2010, at A12.

8. See Estlund, *supra* note 2, at 680 (discussing the downward pressure on wages as a result of increasingly competitive product and capital markets).

9. See *infra* note 35 and accompanying text.

10. Bernhardt et al., *Introduction*, *supra* note 6, at 9, 11-12; Estlund, *supra* note 2, at 673. Among the tasks commonly outsourced are janitorial services, delivery services, food services, apparel production, and low- to semi-skilled construction work. Bernhardt et al., *Introduction*, *supra* note 6, at 12.

11. For example, the hiring of workers through temporary employment agencies and various “contractor” arrangements has accelerated during the recession. See, e.g., Eve Tahmincioglu, *Need a Job? Contract Work Could Be the New Normal*, MSNBC.COM (May 6, 2010, 10:00:53 AM), <<http://www.msnbc.msn.com/id/36826679/>>; Louis Uchitelle, *Labor Data Show Surge in Hiring of Temp Workers*, N.Y. TIMES, Dec. 21, 2009, at A1.

12. See, e.g., Craig Becker, *Labor Law Outside the Employment Relation*, 74 TEX. L. REV. 1527, 1527 (1996) (stating that legal doctrine “decisively promotes” subcontracting).

13. See, e.g., TIMOTHY P. GLYNN ET AL., EMPLOYMENT LAW: PRIVATE ORDERING AND ITS LIMITATIONS 14-15 (2nd ed. 2011).

circumstances in which more exacting control is not necessary, firms can greatly reduce the probability that they will be liable for violations by shifting services or production to independent third-party suppliers.

The disaggregation that results creates significant enforcement obstacles. As other commentators have observed, smaller operations are less visible and therefore detection on the front end is more difficult.¹⁴ Moreover, unless regulators or workers can demonstrate that sufficient control is being exercised by the end-user firm to create “employer” status, they are left to seek remedies against the often undercapitalized labor supplier.¹⁵ And uncertainties regarding coverage lead to both unprosecuted claims and discounted settlements. Critically then, outsourcing does far more than shift legal responsibility from one entity to another: it allows end-user firms to avoid noncompliance risks while benefiting from labor at a price discounted by the low probability of enforcement of work law mandates.¹⁶

In this article, I offer a descriptive account of the phenomenon of enterprise disaggregation and why, in my view, such splintering is likely to continue – even accelerate – in a post-Great Recession world. I will then explore and critique the various approaches taken or proposed to address the impact of disaggregation on compliance with wage and hour laws. These include existing regimes that seek to extend accountability beyond “employers”: among the notable examples are the FLSA’s “hot goods” provision¹⁷ and California’s “brother’s keeper” law.¹⁸ They also include reform proposals offered by other scholars.¹⁹ I contend that all such approaches, although undoubtedly steps in the right direction, ultimately fall short because of their various limitations, the enforcement costs they

14. See, e.g., Weil, *supra* note 6, at 239-40; cf. David Weil, *Enforcing OSHA: The Role of Labor Unions*, 30 INDUS. REL. 20, 20-23 (1991) (finding that inspections and enforcement are more likely in larger and more visible firms that tend to have better compliance records than smaller firms).

15. See Noah Zatz, *Working Beyond the Reach or Grasp of Employment Law*, in THE GLOVES-OFF ECONOMY, *supra* note 6, at 31, 47 (stating that while larger firms generally pay judgments, smaller firms may not have any identifiable assets to support payment).

16. See generally Weil, *supra* note 6, at 243 (discussing a study which – taking into account the average underpayment of a worker, the median civil penalty for noncompliance, the average likelihood of inspection, and a relatively high labor demand elasticity – showed that, for an apparel contractor with thirty-five workers, “the potential cost of not complying [with minimum wage standards] is \$121 versus a benefit of \$12,205”); see also Zatz, *supra* note 15, at 49 (arguing that when enforcement is more difficult to maintain against subcontractors, it is cheaper for end-user firms to subcontract the work because they get the benefit of the savings resulting from the subcontractors’ noncompliance).

17. See 29 U.S.C. § 215(a)(1) (2006).

18. See CAL. LAB. CODE § 2810(a) (West 2009).

19. See *infra* Part III. An important, recent addition to this literature is Professor Brishen Rogers’ proposal to extend liability for wage violations to third-party commercial purchasers of goods and services who fail to exercise due care to prevent upstream wage and hour violations. See generally Rogers, *supra* note 6. I address the merits of this proposal below.

entail, and their failure to eliminate risk-avoidance opportunities for end-user firms.

This article concludes by suggesting a possible way forward. In a world in which resources for public enforcement will remain inadequate and much of the low-wage workforce is likely to remain non-unionized, I argue that one promising way to counteract the compliance-reducing effects of disaggregation is to eliminate the “employer” coverage limitation altogether. Under the regime I propose, commercial actors would be held strictly liable for wage and hour violations in the production of any goods and services they purchase, sell, or distribute, whether directly or through intermediaries. In other words, accountability would extend through the commercial enterprise, unlinked from the exercise of control over the work. The only limitation is that a firm would be liable only for the portion of the violations attributable to the goods or services it purchases, sells, or distributes.

I will introduce the idea of enterprise liability for wage and hour violations here, leaving to a later article a more complete exploration of its potential benefits, costs, and noninstrumental justifications. Still, I will touch on some of its key attributes and consequences.

Because such a regime would extend potential accountability to all commercial purchasers, sellers, and distributors regardless of control, it would greatly reduce the liability-risk discount from outsourcing work to third parties. It also would increase the probability of a solvent defendant without imposing additional enforcement costs in most circumstances, and, hence, the likelihood of public and private enforcement and adequate compensation for victims. Contrary to the fear that commercial actors far removed from and unaware of upstream wage violations would become frequent targets for collection, the practical realities of litigation would steer enforcement efforts toward better-positioned intermediaries.

Ultimately, the elimination of coverage-based barriers to enforcement would prompt commercial actors at serious risk of liability to address their exposure through private ordering, including seeking out reputable suppliers of goods and services, bargaining for indemnification from upstream actors, and putting into place monitoring and other mechanisms to ensure that suppliers maintain compliant practices. Indeed, the end result of eliminating control-based limitations will be a socially beneficial shift in firm risk management techniques: from avoidance through outsourcing, which reduces compliance, to enterprise self-regulation, which promotes it.

Before I begin, I should note two other limitations on my analysis in this article. First, I am not going to address arguments for and against the

minimum wage itself – matters which have been extensively explored elsewhere. My analysis therefore starts from the premise (which I obviously accept but recognize is contestable) that existing wage and hour mandates, including the minimum wage, ought to exist and be enforced.²⁰ Second, I will focus primarily on the instrumental justifications for broad enterprise liability, leaving much of the noninstrumental discussion for later development. However, in addressing why my proposal is not as far removed from existing legal norms as it sounds, I will conclude by showing that this kind of enterprise liability is consistent with the normative underpinnings of a number of existing doctrines within and outside of wage and hour law.

II. ENTERPRISE DISAGGREGATION IN THE MODERN ERA

A. *The Decision to Make It Yourself or Buy It from Someone Else*

In his seminal work, *The Nature of the Firm*,²¹ R. H. Coase set out to identify why firms emerge in a market economy regulated by price movements. Put another way, he sought to answer the following question: When will an entrepreneur seek hired help (employees) instead of purchasing a good or service through contracting with third parties?²² Coase's key insight was that transaction costs increase the total cost of obtaining goods and services in the marketplace beyond their price. These include bargaining costs, renegotiation and monitoring costs, and regulatory costs such as the sales tax.²³ He concluded that firms will arise when these various costs become too high; that is, entrepreneurs can produce what they need by coordinating production through the exercise of their authority at a lower cost than the cost (price plus transaction costs) of obtaining the same in the market. This may occur, for example, when a purchaser of services for more than a short term is unable to state in advance the details of what is expected of the supplier.²⁴ For Coase then, a firm emerges from – and is constituted by – the direction of the factors of

20. For a discussion of the debate over the minimum wage and poverty-reduction and civil-rights based arguments for such a mandate, see generally Noah D. Zatz, *The Minimum Wage as a Civil Rights Protection: An Alternative to the Antipoverty Arguments?*, 1 U. CHI. LEGAL F. 1 (2009); see also Rogers, *supra* note 6, at 7-9 (discussing the debate).

21. Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937).

22. *Id.* at 390.

23. *Id.* at 390-93.

24. *Id.* at 392. It should be noted that Coase qualified his claims in a number of respects, including by recognizing that it not easy to draw a bright line between when there is a firm or not and that there are natural limits to internal production. *Id.* at 392 n.1, 394-95.

production by the entrepreneur.²⁵ The value-enhancing (or cost avoiding) role of control is central.

Coase's theory of the firm has been criticized, and other scholars have offered competing conceptions.²⁶ For example, his sharp distinction between intra- and extra-firm transactions arguably is at odds with the prevailing theory in corporate-law scholarship that the firm is simply a nexus of contractual relationships.²⁷ Nevertheless, his central observations about the comparative costs that drive decisions about the internal or external production of goods and services retain much explanatory power.

Indeed, the substantial shift in these relative costs explains why we have witnessed enterprise disaggregation in recent years. When he wrote his article in the mid-1930s, subcontracting existed, but Coase also observed many large, vertically integrated firms. Such integration remained prominent for some period thereafter, but today, three-quarters of a century later, much has changed. While many forces have contributed to disaggregation,²⁸ one is both clear and profound: regulatory costs now cut decisively in favor of outsourcing many activities.²⁹

B. The Law's Role in the Shift from Integration to Disaggregation

As Coase's analysis acknowledges, the distinction between intra- and extra-firm activities is central to the allocation of legal responsibility. Indeed, the doctrine of respondeat superior, which Coase suggests is a real-world reflection of his control-based conception of the firm, is the starting point.³⁰ Under the doctrine, firms are strictly liable for the torts of their employees committed within the scope of employment; they are not, as a general matter, accountable for torts committed by independent contractors.³¹ The boundaries of the firm – i.e., the employer – hinge on

25. *Id.* at 394-95.

26. See Stewart J. Schwab, *Coase's Twin Towers: The Relation Between the Nature of the Firm and the Problem of Social Cost*, 18 J. CORP. L. 359, 360-65 (1993) (discussing criticisms and competing views).

27. *Id.* at 365.

28. Although I will not detail here the various forces that have altered economic organizations, they extend well beyond legal changes, and include globalization, changing capital and labor markets, and new production systems. See, e.g., Becker, *supra* note 12, at 1530-32 (discussing how firm outsourcing allows restructuring of relationships with workers so that firms can acquire and use labor just as they acquire and use commodities); Rogers, *supra* note 6, at 14-17.

29. See Becker, *supra* note 12, at 1527.

30. See Coase, *supra* note 21, at 403-04.

31. See RESTATEMENT (SECOND) OF AGENCY § 219 (1958). A "master" or employer is "a principal who employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service." *Id.* § 2(1). Correspondingly, a servant or employee is "an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right

how much “control” the firm exercises or has a right to exercise over the manner or details of the work.³²

Coase recognized the role of the law in determining which activities would be carried out in the market or by the firm, but his examples – including the sales tax – all would encourage internalization.³³ Interestingly, however, respondeat superior cuts the other way: firms can avoid tort risks by externalizing production onto others. And, as it turns out, this is part of the disaggregation story, given that tort-related risks for firms have grown in many areas since the 1930s. Yet there is much more. Respondeat superior’s distinction between employment and nonemployment relationships also has had a significant influence on the allocation of legal responsibility in statutory regimes, many of which did not exist in the 1930s. And the legal risks and compliance costs associated with these regimes often are decisive.

Take labor and employment law. Nearly all state and federal statutory protections for workers (almost all of which have emerged since the New Deal) protect only “employees” and impose duties only on “employers.”³⁴ While the tests for determining employment status vary, the exercise of

to control by the master.” *Id.* § 2(2). In contrast, an independent contractor is one “who contracts with another to do something for him but who is not controlled by the other nor subject to the other’s right to control with respect to his physical conduct in the performance of the undertaking.” *Id.* § 2(3).

32. Section 220 of the *Restatement (Second) of Agency* goes on to provide a more detailed definition of “servant,” a term since displaced by “employee,” containing a nonexclusive list of factors for determining servant/employee status. Subpart (1) provides that a “servant is a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other’s control or right to control.” *Id.* § 220(1). Subpart (2) provides a number of factors that, among others, are considered in determining whether one acting for another is a servant or an independent contractor:

- (a) the extent of control which, by the agreement, the master may exercise over the details of the work;
- (b) whether or not the one employed is engaged in a distinct occupation or business;
- (c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;
- (d) the skill required in the particular occupation;
- (e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;
- (f) the length of time for which the person is employed;
- (g) the method of payment, whether by the time or by the job;
- (h) whether or not the work is a part of the regular business of the employer;
- (i) whether or not the parties believe they are creating the relation of master and servant; and
- (j) whether the principal is or is not in business.

Id. § 220(2). The *Restatement (Third) of Agency* contains a similar definition, although the wording varies slightly, including abandonment of “servant” in favor of “employee.” See RESTATEMENT (THIRD) OF AGENCY § 7.07 (3)(a) (2006) (stating “an employee is an agent whose principal controls or has the right to control the manner and means of the agent’s performance of work”).

33. See Coase, *supra* note 21, at 393.

34. See, e.g., Labor Management Relations Act of 1947, 29 U.S.C. §§ 152(2)–(3) (2006); National Labor Relations Act, 29 U.S.C. § 158(b)(4)(i) (2006); Employee Retirement and Income Security Act, 29 U.S.C. § 1002 (5)–(6) (2006); Fair Labor Standards Act of 1938, 29 U.S.C. § 203(2) (2006); Family Medical Leave Act of 1993, 29 U.S.C. § 2611(3) (2006); Age Discrimination in Employment Act of 1967, 29 U.S.C. § 630(f) (2006); Civil Rights Act of 1964, Title VII, 42 U.S.C. § 2000e(f) (2006); Americans with Disabilities Act of 1990, 42 U.S.C. § 12111(4) (2006).

control usually is central to the analysis.³⁵ There are two closely related aspects of this inquiry. The first is whether the worker is an employee (of anyone) or an independent contractor; the second is whether a party is an employer of the employee. Focusing on the second, a firm is not accountable for legal violations unless it exercises or has the right to exercise sufficient control over workers' activities to be deemed an employer. This produces a feedback loop: labor and employment law seeks to define the boundaries of the firm for purposes of allocating legal responsibility, and, in so doing, alters the relative costs of internal and external production. If a firm can avoid exercising control by externalizing production, it can eliminate the significant employment-related regulatory costs it would bear if it produced goods and services internally.

An economist might respond that, all else being equal, regulatory costs would not contribute to the shift to external production because these costs would tend to be reflected in the price of goods and services the firm purchases from other firms who have to absorb these very costs. But all else is not equal. Obviously, regulatory costs can be avoided by shifting production to firms operating beyond the reach of our regulatory regime – that is, across international borders. Yet they can also be avoided domestically through fragmentation of operations. Because of the inapplicability and underenforcement of labor and employment mandates in smaller firms, these regulatory costs frequently are *not* reflected in the price of goods and services produced by these firms. The cost-savings is then bolstered by innovations in inter-firm relationships (driven in part by the foregoing incentives) that has led to a decline in the transaction costs associated with relinquishing control that Coase identified, particularly for work at the low end of the labor market.³⁶

Since reducing the cost of labor produces very direct cost savings, this dynamic has played out in a profound way with regard to wage and hour obligations at the low end of the labor market. Enforcement problems in

35. For example, the FLSA defines an "employee" as "any individual employed by an employer." 29 U.S.C. § 203(e)(1) (2006). The statute in turn defines "employ" as "to suffer or permit to work," *id.* § 203(g), and "employer" to include "any person acting directly or indirectly in the interest of an employer." *Id.* § 203(d). Congress intended these terms to be defined expansively, with "striking breadth," in such a way as to "stretch . . . the meaning of 'employee' to cover some parties who might not qualify as such under a strict application of traditional agency law principles." *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992); Bruce Goldstein et al, *Enforcing Fair Labor Standards in the Modern American Sweatshop: Rediscovering the Statutory Definition of Employment*, 46 U.C.L.A. L. REV. 983, 1041 (1999). This inquiry often is referred to as the "economic realities" approach. However, as discussed below, the multifactor tests that the courts actually adopt and apply use factors that, like the common law, emphasize control and integration, along with other considerations. *See infra* Part III.A.

36. *Cf.* Becker, *supra* note 12, at 1530-32 (discussing changes in supply practices).

labor and employment law at this end of the market are well known. Factors leading to underenforcement of wage and hour and other employment law mandates include the social and economic vulnerability of low-wage workers, their lack of awareness of workplace rights, limited resources for public enforcement, limited remedies and other incentives for private enforcement, procedural hurdles, and the limited effect of unions and advocacy organizations.³⁷

But outsourcing adds further obstacles to enforcement.³⁸ For one thing, smaller firms may be excluded from statutory mandates and can opt to engage in practices that produce labor-cost savings – such as not providing health and other benefits – without suffering the tax penalty or other consequences larger firms would face.³⁹ Even when such firms are subject to the same regulatory requirements as larger firms, detection of violations is more difficult because small firms are less visible, there are high levels of entry and exit, the layering and shifting of inter-firm relationships stretches limited public monitoring resources, and fragmentation makes it harder for unions and advocacy organizations to rein in violators.⁴⁰ Moreover, smaller operators (and their principals) are more likely to be judgment proof, which leads to under-deterrence and makes adequate compensation for victimized workers improbable.⁴¹ Indeed, the possibility of enhanced penalties for knowing violations – such as liquidated damages under the FLSA – may have little or no impact on fly-by-night or other thinly capitalized labor suppliers.⁴² And the difficulty in finding a solvent target reduces substantially incentives for private and public enforcement.⁴³

Of course, even under the existing “employer” limitations, workers and regulators can seek to extend liability to larger firms that engage the services of smaller ones by demonstrating that the former remains an

37. See generally Craig Becker & Paul Strauss, *Representing Low-Wage Workers in the Absence of a Class: The Peculiar Case of Section 16 of the Fair Labor Standards Act and the Underenforcement of Minimum Labor Standards*, 92 MINN. L. REV. 1317 (2006); Cynthia Estlund, *Rebuilding the Law of the Workplace in an Era of Self-Regulation*, 105 COLUM. L. REV. 319, 330, 348-49, 360-61 (2005); Ruckelshaus, *supra* note 6, at 383-88; Zatz, *supra* note 15, at 31.

38. See, e.g., Weil, *supra* note 6, at 239-40; see also Rogers, *supra* note 6, at 19-20 (discussing various barriers to enforcement in fragmented enterprises).

39. Cf. Estlund, *supra* note 2, at 686 (discussing the various ways in which externalizing some work allows a firm to avoid regulatory and other constraints that would apply internally).

40. See, e.g., *id.* at 682, 687; Weil, *supra* note 6, at 239-40.

41. See Estlund, *supra* note 37, at 330; Goldstein et al., *supra* note 35, at 940; Zatz, *supra* note 15, at 47.

42. See, e.g., Alan O. Sykes, *The Economics of Vicarious Liability*, 93 YALE L.J. 1231, 1232 (1984) (discussing the problems with incentivizing judgment proof actors).

43. Cf. Rogers, *supra* note 6, at 20-21 (discussing the challenges for private and public enforcement).

“employer” or “joint employer” of the latter’s workers. As I will return to below, the potential for such an extension of liability is perhaps greatest in the wage and hour context since the FLSA’s definition of employment arguably is the broadest of any federal labor or employment law statute.⁴⁴ And workers do sometimes prevail under these theories, particularly where an end-user firm clearly is trying to have it both ways – that is, outsourcing tasks to an independent firm but continuing to direct the work.⁴⁵

Ultimately, however, this possibility is inadequate to deter violations and compensate victims. First, workers and regulators must demonstrate sufficient control by the larger firm. The uncertainty and litigation costs associated with establishing coverage lead to heavily discounted settlements or unprosecuted claims. And courts have been reluctant to extend employer status through multiple layers of distinct entities.⁴⁶

Second, and perhaps most fundamentally, establishing extended employer status is not possible where control is not exercised, and, as suggested above, detailed control often is not necessary for low-skilled work. With regard to such work, it is relatively easy for the purchasing firm to demand exacting quality without exerting much ongoing control over operations. In other words, since the work itself is relatively easy to perform, ensuring the resulting good or service meets time and quality specifications is achieved by means other than oversight of the actual work.⁴⁷ For example, in competitive markets, detailed quality standards backstopped by the risk of exit and substitution – i.e., the end-user firm’s purchasing such goods or services elsewhere – may be enough alone.

Thus, leaving aside all of the other impediments to enforcement of their rights, those workers hired by small, thinly capitalized firms to engage in many types of low-skilled work – including cleaning and janitorial services; landscaping and agricultural work; delivery services; light manufacturing; low-end construction work; and retail, restaurant, and food services – may have no viable defendant to hold accountable for violations. The net effect of disaggregation and the other enforcement barriers low-

44. See *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 325 (1992); Goldstein et al., *supra* note 35, at 1008.

45. There are well-known examples in low-wage industries. See, e.g., *Ansoumana v. Gristede’s Operating Corp.*, 255 F. Supp. 2d 184, 186 (S.D.N.Y. 2003) (finding Duane Reade to be a joint employer of delivery workers hired through another firm); Steven Greenhouse, *3 Chains Agree in Suit Over Janitors’ Wages and Hours*, N.Y. TIMES, Dec. 7, 2004, at A19 (discussing a settlement in wage litigation between three California supermarket chains and janitors hired through cleaning contractors).

46. See *infra* note 71, and accompanying text.

47. Cf. Rogers, *supra* note 6, at 14-16 (discussing the underlying literature on innovations in organizational structures that have facilitated the outsourcing of substantial tasks once kept inhouse to assure coordination and quality).

wage workers face is significant underenforcement of wage and hour laws. And, indeed, violations of wage and hour mandates are widespread at the low end of the labor market.⁴⁸

Disaggregation therefore does more than shift legal responsibility. Where detailed control is not necessary, end-user firms can significantly reduce the risk of liability for violations by shifting production to independent third-parties. This allows such firms (and other visible firms with market power) to avoid noncompliance risks while benefitting from labor at a price discounted by the lower probability of enforcement.

C. Racing to Outsource, Racing to the Bottom

Returning then to the Coasian make-it-within or buy-it-without inquiry, the takeaway is clear. Because the price of goods and services produced by low-skilled labor reflect a regulatory cost discount *and* the transaction costs associated with assuring quality are low, incentives regarding this kind of work cut decisively in favor of buying rather than making. Restructuring the enterprise through disaggregation, therefore, can be viewed as among the prevailing forms of value-enhancing “innovation” in the modern era, since fragmentation often produces great value through significant cost savings, perhaps more so than many innovations in internal practices and methods that improve coordination and productivity. Indeed, despite developments that Coase suggested would tend to make firms larger, including technologies that make spatial coordination easier and improved managerial techniques, we observe the opposite phenomenon.⁴⁹

Moreover, since firms that might otherwise opt not to outsource work face price pressures from those that do, disaggregation may be essential in competitive capital and product markets, facilitating the race to the bottom. Indeed, given that quality is relatively easy to maintain, once services are commodified through contractual arrangements with suppliers, and there is competitive and potentially continuous bidding among such suppliers, there will be fierce price competition that applies further downward pressure on labor costs.⁵⁰

The results are everywhere. While a large or medium-size firm in the middle of the twentieth century might have produced its own component parts and other inputs, and provided its own janitorial, maintenance,

48. *See supra* note 6.

49. *Cf. Coase, supra* note 21, at 397. In fact, communications and other technology have helped spur disaggregation by, among other things, rendering supply chain management less expensive. *See Rogers, supra* note 6, at 16.

50. *See Becker, supra* note 12, at 1531.

copying, printing, food, delivery, distribution, and storage services, these tasks now have been shifted to independent firms, sometimes through multiple intermediaries or supply chains. Far from being merely common, outsourcing production overseas and domestically is standard practice.⁵¹ This also corresponds with the rise of “contingent labor” within the United States,⁵² as well as the decline of traditional long-term employment relationships.⁵³ It contributes to the depression of wages at the low end of the market and rising income inequality,⁵⁴ and, as discussed above, has helped facilitate wide-scale violations of basic wage and hour protections.⁵⁵

Absent intervening legal or economic changes that alter fundamentally the costs of disaggregation, this trend seems likely to continue until all tasks are outsourced except aspects of the firm’s production that must remain under exacting control of firm managers. For many visible, high-value firms, these core functions will be associated with highly skilled labor.⁵⁶ They include work that creates or produces the firm’s primary goods or services – e.g., finished goods, software, technological innovation, creative works, and professional services – and tasks that must be strictly controlled for one reason or another, such as to ensure quality or protect trade secrets, confidential information, reputation, client relationships, or good will. Most low and unskilled work therefore will be relegated to small, independent suppliers.

In fact, additional developments that link legal responsibility to “employer” status are likely to spur further disaggregation. For example, this is a potential unintended consequence of employer mandates in the recent health care reform legislation, which, beginning in 2014, will impose tax penalties on employers with fifty or more workers who fail to provide

51. See, e.g., Estlund, *supra* note 2, at 673; see also Becker, *supra* note 12, at 1528-32 (discussing the phenomenon of disintegration of enterprises).

52. For a discussion of the growth of the contingent workforce, see generally Stephen F. Befort, *Revisiting the Black Hole of Workplace Regulation: A Historical and Comparative Perspective of Contingent Work*, 24 BERKELEY J. EMP. & LAB. L. 153 (2003); Richard S. Belous, *The Rise of the Contingent Work Force: The Key Challenges and Opportunities*, 52 WASH. & LEE L. REV. 863, 876-78 (1995); Kenneth G. Dau-Schmidt, *The Labor Market Transformed: Adapting Labor and Employment Law to the Rise of the Contingent Work Force*, 52 WASH & LEE L. REV. 879 (1995).

53. See, e.g., Becker, *supra* note 12, at 1531-32; Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace for Labor and Employment Law*, 48 U.C.L.A. L. REV. 519, 572-76 (2001) (discussing the changing nature of the workforce and its implications for existing workplace regulation).

54. See, e.g., Becker, *supra* note 12, at 1533-34; Estlund, *supra* note 2, at 673.

55. See *supra* notes 14-16 and accompanying text.

56. Cf. Becker, *supra* note 12, at 1530 (discussing the trend toward firms’ outsourcing all work except their “core competencies”). It is worth noting that firms also outsource many tasks requiring greater skills or education, a trend that has accelerated in recent years.

health coverage or coverage that is affordable.⁵⁷ Firms looking to avoid either paying for health benefits for lower-wage workers or paying the tax penalty will have powerful incentives to shift that work to independent suppliers (to reduce their workforce to below the fifty-employee threshold).

Finally, I should note that, in addition to the cost-centered analysis described above, behavioral and social factors can drive or bolster both disaggregation and the norm of noncompliance at the low end of the market. Firm managers' moral or ethical commitments to "their employees" may compel them initially to treat these workers well and even resist layoffs or outsourcing. However, a manager's sense of moral obligation to treat workers well – or at least fairly – is less likely to extend to workers engaged by third parties.⁵⁸ Thus, once work is outsourced or habitually contracted out to independent suppliers, managers of end-user firms will lack a sense of responsibility for their welfare. Their labor is no longer linked to persons to whom a moral duty is owed; it is instead just another commodified input to be purchased at the lowest price.⁵⁹ Indeed, it is not difficult to imagine some managers choosing to outsource various activities *because* they do not want to bear such moral responsibility. Similarly, the disassociation that results from disaggregation can break the bonds of cooperation and support between workers or prevent them from forming in the first place.⁶⁰

Reputational concerns also can spur disaggregation. Much recent attention has been focused on how such concerns can press reputation-dependent firms to internalize norms of compliance and decent working conditions and, in some cases, to take greater responsibility for the welfare of workers in their international and domestic supply chains.⁶¹ Yet, in other contexts, reputation can cut in the opposite direction. It may be easier (and far cheaper) for a visible firm to maintain its reputation as a "good

57. See 26 U.S.C. § 4980H (Supp. IV 2010) (codifying the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Title I § 10108, 124 Stat. 119 (2010) (as modified by the Health Care and Education Reconciliation Act of 2010, Pub. L. 111-152, 124 Stat. 1029 (2010)).

58. Cf. Thomas C. Kohler, *Civic Virtue at Work: Unions as Seedbeds of the Civic Virtues*, 36 B.C. L. REV. 279, 285 (1995) (discussing the lack of any legal or moral obligation on the part of a firm to offer contingent workers the kinds of benefits and protections afforded to its employees).

59. Cf. Becker, *supra* note 12, at 1531 (discussing the commodification of labor). This is consistent with studies showing that contract or contingent workers are given less occupational safety training (and other safety-related resources) than regular employees, which may help explain the differential in health risks between contingent and traditional workers. See, e.g., Kristin J. Cummings & Kathleen Kreiss, *Contingent Workers and Contingent Health: Risks of a Modern Economy*, 299 JAMA 448 (2008).

60. See Becker, *supra* note 12, at 1534-35 (discussing the consequences of worker disassociation that results from fragmentation of the enterprise).

61. See, e.g., Estlund, *supra* note 2, at 690 (discussing Nike's supply chain monitoring efforts and the efforts of other high-visibility firms).

employer” – i.e. offering generous pay and benefits to its workforce – if it offloads low-skilled/low-wage work onto others. And this incentive may be particularly acute when reputation is tied to some objective measure. Thus, for example, further disaggregation may be an unintended consequence of the new CEO compensation disclosure mandated by the Dodd-Frank Wall Street Reform and Financial Protection Act, which requires a firm registered under the Securities Exchange Act to disclose annually the ratio between its CEO’s compensation and that of its median employee.⁶² To the extent decision makers in a publicly traded firm have reason to care about the reputational consequences of this disclosure, they can improve both the median and the ratio by taking low-wage workers “off the books” through shifting their work to third parties. Indeed, this is likely to be perceived as a better and cheaper option than paying the CEO less or paying workers currently at the median more.

III. EXISTING AND PROPOSED RESPONSES TO DISAGGREGATION AND NONCOMPLIANCE

In recent years, the rise of wage and hour violations have focused greater attention on the enforcement gap at the low end of the labor market, including the impact of outsourcing on compliance. Of course, legal reform proposals run the gamut, and include, for example, enhancing public enforcement efforts, stiffening civil and criminal penalties for violators, reducing or eliminating procedural hurdles in private litigation, expanding and strengthening collective bargaining rights, and establishing various kinds of third-party monitoring regimes.⁶³

Yet, in an age of disaggregation in which resources for public enforcement and ongoing monitoring will remain inadequate, “employer” coverage limitations will continue to be a central impediment to deterring violations and adequately compensating victims. To address the problem, policy makers and scholars have sought to expand legal responsibility beyond the “employer” as traditionally defined. Although each of these existing and proposed extensions is or would be an improvement, none

62. Pub. L. No. 111-203, § 953(b), 124 Stat. 1376, 1904 (2010) (to be codified at 15 U.S.C. § 781n.).

63. Estlund, *supra* note 37, at 374-95 (discussing various mechanisms for triggering monitoring and self-regulation); Zatz, *supra* note 15, at 50-56 (discussing various reform proposals); David Weil, *Crafting a Progressive Workplace Regulatory Policy: Why Enforcement Matters*, 28 COMP. LAB. L. & POL’Y J. 125 (2007); see also Katherine V.W. Stone, *Legal Protections for Atypical Employees: Employment Law for Workers Without Workplaces and Employees Without Employers*, 27 BERKELEY J. EMP. & LAB. L. 251, 283-86 (2006) (discussing a number of reform proposals to protect vulnerable workers).

goes far enough.

A. Expanding the Definition of “Employer”

One frequently discussed approach to improving enforcement is to press legal decision makers (in particular judges) to apply the broad “economic realities” framework for determining whether an employment relationship exists. Because this approach is supposed to focus on “worker dependence” and, relatedly, business integration, rather than a finding of exacting control over the work, it potentially extends the reach of employment beyond the common-law control test.⁶⁴ Commentators argue that this framework, if applied liberally, not only reflects the intent of Congress in enacting the FLSA,⁶⁵ but also would sweep more workers within the definition of “employee” and extend “employer” and “joint employer” status to a greater number of firms purchasing services through contractual arrangements with labor suppliers.⁶⁶

Greater adherence to a broad economic realities approach would benefit some workers seeking to vindicate their rights. But, as Professor Brishen Rogers has recently argued, it would fall far short of adequately addressing the consequences of disaggregation.⁶⁷ As an initial matter, even courts purporting to apply an economic realities test have shown reluctance to extend “employer” status beyond firms that exercise control akin to that required under the common-law test.⁶⁸ Further, because dependence, control, and integration are related concepts which hinge on the particulars of the work arrangements, the factors for determining a worker’s or firm’s status under the economic realities approach often overlap with those utilized under a common-law control inquiry.⁶⁹ Indeed, as recognized even

64. See Zatz, *supra* note 15, at 51.

65. See Goldstein, *supra* note 35, at 1043-48.

66. See, e.g., *id.* at 989 (arguing for this broad test and a standard centered on whether work is integrated into the business); Katherine V.W. Stone, *Rethinking Labor Law: Employment Protection for Boundaryless Workers*, in BOUNDARIES AND FRONTIERS OF LABOR LAW 155, 155 (Guy Davidov & Brian Langille eds., 2006); Zatz, *supra* note 15, at 50-51 (discussing this strategy for extending accountability); *cf.* Stone, *supra* note 63, at 284 (discussing this approach although recognizing potential limits).

67. See Rogers, *supra* note 6, at 21-29.

68. See *id.* at 4, 24-25. This may be due to an overriding concern of extending liability too far. *Cf.* Torres-Lopez v. May, 111 F.3d 633, 641 (9th Cir. 1997) (noting the concern of the lower court that an expansive approach would result in few situations in which a grower would not be deemed an employer). It also may be attributable to judges’ ingrained social and economic understanding of the employment relationship. See Rogers, *supra* note 6, at 27-28.

69. See Rogers, *supra* note 6, at 4, 24-25; see also RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 1.01 cmt. a (Tentative Draft No. 2, 2009) (suggesting that courts that have relied on the common-law and economic realities approaches have tended to utilize the same factors and reach the same results). Indeed, some courts deny any substantive difference between the tests. See, e.g., Murray v. Principal

by those favoring a more robust economic realities inquiry, the multi-factor tests courts and the Department of Labor (“DOL”) have articulated under this rubric have been criticized as lacking normative clarity and producing arbitrary and inconsistent results.⁷⁰

Looking forward, even if applied with renewed vigor and greater clarity, coverage under the economic realities approach is inherently uncertain, particularly where goods or services are supplied to a purchasing firm through multiple layers of contractual relationships (often designed, at least to some extent, to avoid an extension of liability).⁷¹ Establishing employer status for end-user firms therefore would continue to require a fact-based, case-by-case inquiry, entailing significant enforcement costs and often rendering public and private enforcement ineffective – that is, resulting in heavily discounted settlements and, worse, unprosecuted claims. Moreover, because employer status would still hinge on at least some operational integration, this coverage extension would not capture workers where operational control really has been relinquished to the third-party provider, which, as I suggest above, now is often the case.⁷² Put another way, the “economic realities” framework does not match today’s economic reality, in which low-wage labor supplier-purchaser arrangements often are between separately operated firms, belying a genuinely integrated enterprise. Thus, seeking to identify the “employer” under this framework, even if more sound and aligned with the aims of the FLSA, would suffer from the same kinds of scope and enforcement limitations that have rendered the common-law approach ineffective.⁷³

Fin. Grp., Inc., 613 F.3d 943, 945 (9th Cir. 2010) (stating that “there is no functional difference” between the tests of common-law control, economic realities, and a so-called hybrid of the two).

70. See Goldstein et al., *supra* note 35, at 1055 (discussing the tests as a quagmire, the significance of which eludes judicial decision makers); Michael C. Harper, *Defining the Economic Relationship Appropriate for Collective Bargaining*, 39 B.C. L. REV. 329, 339-40 (1998) (criticizing the range-of-factors approach courts have applied under the economic realities rubric as one that does not provide predictability and could point to opposite conclusions in the same case); *Rogers*, *supra* note 6, at 4, 24-25.

71. See, e.g., Estlund, *supra* note 37, at 348-49. For example, if the economic realities inquiry requires a focus on whether the work is integrated into the business, see Goldstein, et al., *supra* note 35, at 989, FLSA liability would extend beyond what many courts currently allow. But this inquiry, like exacting control or dependence, is likely to be highly context specific. Moreover, as firms respond and adapt to this standard, and push more tasks to others who can be characterized as undertaking an independent business, these enforcement difficulties will become even more pronounced.

72. See *Rogers*, *supra* note 6, at 17 (stating that many semi- and low-skilled workers are separated from end-user firms by two or more intermediaries and are, therefore, not employees of these firms in any meaningful sense); see also *Martinez v. Combs*, 231 P.3d 259 (Cal. 2010) (finding field representative and produce merchants not liable to strawberry field workers for unpaid wages because workers failed to demonstrate that these defendants exercised control over working conditions, and the farmer, rather than these defendants, had entrepreneurial control over the farming).

73. It is worth noting that attempting to reframe the inquiry in other ways to identify those parts of work that are “essential” or “integral” to the purchasing firm’s operations (i.e., traditionally within

Another, related reconceptualization of “employment” that is growing in influence shifts the focus from determining the level of control over the work itself to an inquiry into entrepreneurialism – that is, determining who exercises entrepreneurial control over the work and has significant entrepreneurial opportunity for gain or loss. Again, this kind of inquiry would be relevant both in determining who is an “employee” rather than independent contractor and who is an “employer” (rather than a non-employer principal or third party). In a 1996 article, Professor Michael Harper proposed this kind of approach to defining the contours of the employment relationship in the labor context,⁷⁴ and the National Labor Relations Board (NLRB) later adopted a similar test in addressing a dispute between Corporate Express Delivery Systems and drivers it had classified as independent contractors.⁷⁵ The focus on entrepreneurialism also is reflected in the most current draft of the *Restatement (Third) of Employment Law*⁷⁶ and in some state-law regimes, such as the Illinois Employee Classification Act.⁷⁷

scope of the firm’s work) would not improve matters. Such touchstones are equally amorphous, and, of course, they have lost much of their meaning over time since more and more activities once performed within vertically integrated firms are now being performed by layers of outsiders

74. See Harper, *supra* note 70, at 342-43.

75. See Corp. Express Delivery Sys. v. NLRB, 292 F.3d 777, 780 (D.C. Cir. 2002) (affirming the NLRB’s conclusion that “putative independent contractors have ‘significant entrepreneurial opportunity for gain or loss,’” quoting *In re Corp. Express Delivery Sys. & Teamsters Local 886*, 332 N.L.R.B. 1522, 1522, 1527 (2000)).

76. See RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 1.01 (Tentative Draft No. 2, 2009) (providing that an employment relationship exists whenever a worker acts, at least in part, to serve the interests of the employer; the employer consents to receive the services of the worker; and the worker is not rendering services as an independent business, which means that the worker does not exercise entrepreneurial control over the manner and means of the work – entrepreneurial control is defined as “control over important business decisions, including whether to hire and where to assign assistants, whether to purchase and where to deploy equipment, and whether and when to service other customers”).

77. See 820 ILL. COMP. STAT. 185/10 (2010). The relevant part of the statute provides that an individual performing services for a construction contractor is an employee of the contractor unless:

- (1) the individual has been and will continue to be free from control or direction over the performance of the service for the contractor, both under the individual’s contract of service and in fact;
- (2) the service performed by the individual is outside the usual course of services performed by the contractor; and
- (3) the individual is engaged in an independently established trade, occupation, profession or business; or
- (4) the individual is deemed a legitimate sole proprietor or partnership under subsection (c) of this Section.

Id. § 10(b). Subsection (c) defines a legitimate sole proprietorship or partnership as, among other things, one that performs a service “free from the direction or control over the means and manner of providing the service,” *id.* § 10(c)(1), “has a ‘substantial investment of capital in the sole proprietorship or partnership beyond ordinary tools and equipment and a personal vehicle,’” *Id.* § 10(c)(3), and “owns the capital goods and gains the profits and bears the losses of the sole proprietorship or partnership.” *Id.* § 10(c)(4).

This approach would bring analytical clarity to the inquiry lacking in the existing common-law and economic realities frameworks. But its adoption would not substantially alter the consequences of disaggregation in the wage and hour context. Although its application likely would be less arbitrary and uncertain, it too is fact based and case specific, so enforcement would be dampened by litigation costs associated with establishing coverage. More importantly, while such a regime would benefit some groups of workers (mis)classified as independent contractors, it would not result in the expansion of legal responsibility to purchasing firms where small, independent suppliers are genuinely distinct in terms of capital investment, corporate formalities, and entrepreneurial decision making. Once again, such separation is frequently and fairly easily achieved in production of goods and services requiring few skills.

Notably, seven years after the District of Columbia Circuit's *Corporate Express* decision, the same court reversed the NLRB's holding that drivers for FedEx Home Delivery were "employees" under the NLRA.⁷⁸ In finding that the drivers were independent contractors, the court emphasized that 25 percent of the contractors owned multiple vehicles, had multiple routes, and hired their own employees.⁷⁹ Whether the *FedEx* decision was correct or not, the takeaway for end-user firms is clear: by facilitating seemingly genuine entrepreneurial intervention, delivery-service enterprises like FedEx can avoid the fate of *Corporate Express*. In most other low-wage contexts, such intervention by third-party operators – who hire the underlying workers, exercise genuine entrepreneurial control, and bear ownership-related opportunities for gain and loss – already is standard practice.

B. Existing and Proposed Extensions Beyond the "Employer"

In some circumstances, state and federal law extends responsibility for wage and hour violations beyond the "employer," and commentators have advocated related extensions. Much of the recent legal innovation along these lines has been at the state level, but the FLSA's "hot goods" provision provides a long-standing example. While each existing and proposed extension beyond first-party employers can facilitate somewhat greater deterrence and enforcement, each is, for one reason or another, too

78. *FedEx Home Delivery v. N.L.R.B.*, 563 F.3d 492, 504 (D.C. Cir. 2009).

79. *Id.* at 499 (emphasizing the fact that twenty-five percent of contractors hired their own employees and had multiple trucks and routes important to courts analysis). The court also noted that the routes were assignable without FedEx's permission – further evincing entrepreneurial control. *Id.* at 500.

limited to address fully the consequences of disaggregation.

The “hot goods” provision authorizes the Secretary of Labor to seek to enjoin the transportation or sale of “goods in the production of which any employee was employed in violation” of the FLSA.⁸⁰ Congress’s aim in granting the Secretary the power to prevent downstream parties – i.e., commercial actors beyond the employer who committed the underlying violations – from transporting or selling hot goods was to deter and prevent the unfair competition that results from such trade.⁸¹ Moreover, in stating his support for the provision, President Roosevelt declared that because they were produced in violation of wage laws, hot goods ought to be treated like “contraband.”⁸² The provision also can serve a compensatory function: despite the fact that the Secretary’s authority is limited to seeking an injunction, the enjoined party can purchase relief under the statute by remedying past FLSA violations.⁸³

In addition to exempting consumers and common carriers from its coverage, the hot goods provision excludes purchasers who obtain the goods “in good faith reliance on written assurances from the producer” that the goods were produced in conformity with the FLSA and “without notice of any such violation.”⁸⁴ However, the underlying regulations issued pursuant to the hot goods provision set a fairly demanding standard for a purchaser to avoid the issuance of an injunction.⁸⁵ They state that the act imposes “an affirmative duty” on each purchaser “to assure himself that the goods in question were produced in compliance” with the FLSA.⁸⁶ The regulations also clarify that a purchaser’s compliance with the “good faith” requirement is to be evaluated by use of the reasonable person standard.⁸⁷

As other scholars have discussed, the hot goods provision is a rare manifestation (in federal labor and employment law) of the recognition that the broader commercial enterprise may promote underlying violations, that

80. 29 U.S.C. § 215(a)(1) (2006).

81. See *Citicorp Indus. Credit, Inc. v. Brock*, 483 U.S. 27, 36 (1987) (stating that Congress intended the FLSA to “eliminate the competitive advantage enjoyed by goods produced under substandard conditions”).

82. S. REP. NO. 75-884, at 2 (1937) (“Goods produced under conditions which do not meet rudimentary standards of decency should be regarded as contraband and ought not to be allowed to pollute the channels of interstate commerce.”).

83. *Citicorp Indus. Credit*, 483 U.S. at 38-39; see Leo L. Lam, Comment, *Designer Duty: Extending Liability to Manufacturers for Violations of Labor Standards in Garment Industry Sweatshops*, 141 U. PA. L. REV. 623, 652 (1992) (discussing that the DOL has threatened apparel manufacturers with a hot goods freeze on the shipment of their products unless they tender back wages owed).

84. 29 U.S.C. § 215(a)(1) (2006).

85. See Rogers, *supra* note 6, at 30.

86. 29 C.F.R. § 789.1 (2010).

87. See *id.*

downstream commercial actors therefore may bear some responsibility for such violations, and that deterrence and prevention may require targeting such actors.⁸⁸ And it has been deployed effectively in some contexts. For example, during the 1990s, the DOL enjoined a number of large retailers from selling garments produced in violation of the FLSA, even though the retailers themselves played no role in designing or manufacturing the garments.⁸⁹

But both the reach and effectiveness of this provision are limited in fundamental respects. As its name suggests, it only applies to goods transported in interstate commerce, not services. In addition, although enforcement may facilitate compensation in some contexts, the remedial hammer available to regulators – injunctive relief – is a relatively weak one. Moreover, as I will return to below, the provision’s effectiveness may be limited further by the fact that it contains a fault-based limitation. Finally, and perhaps most importantly, it does not create a private right of action.⁹⁰ Its use and effectiveness thus are subject to the characteristics of the prevailing political climate⁹¹ and, relatedly, the availability of sufficient resources for enforcement.⁹²

In recent years, a number of reforms at the state level have sought to extend accountability beyond first-party employers. One well-known example is California’s antisweatshop law, known as AB 633, which makes garment manufacturers guarantors of their subcontractors’ wage and hour practices.⁹³ Under this provision, if unpaid wages cannot be collected from the subcontractor due to insolvency, they can be collected from the manufacturer without the need to demonstrate an employment relationship.⁹⁴

Although AB 633 has been hailed as a significant victory for those advocating on behalf of garment workers,⁹⁵ the law’s limitations and lax enforcement efforts have hampered its effectiveness. Perhaps most importantly, like the hot goods provision, this statute does not provide for a private right of action. Thus, workers must file with and then rely on the California Department of Labor to pursue claims. Worker advocates have

88. See, e.g., Becker, *supra* note 12, at 1554; Estlund, *supra* note 37, at 349.

89. Estlund, *supra* note 37, at 349, 385-86.

90. See 29 U.S.C. § 215(a)(1) (2006).

91. See Rogers, *supra* note 6, at 31 (“The effectiveness of FLSA’s hot goods provision is subject to fickle political will.”).

92. See Lam, *supra* note 83, at 653.

93. CAL. LAB. CODE § 2673.1 (West 2010).

94. See *id.*

95. See Scott L. Cummings, *Hemmed In: Legal Mobilization in the Los Angeles Anti-Sweatshop Movement*, 30 BERKELEY J. EMP. & LAB. L. 1, 46 (2009).

criticized state regulators for failing to enforce the act in many circumstances and for delays in adjudicating claimed violations.⁹⁶

Other recently enacted provisions are potentially more robust. Illinois's Day Labor Services Act holds third-party clients responsible for wage violations committed by day or temporary labor service agencies.⁹⁷ Like California's AB 633, it imposes strict (vicarious) liability on non-employer third parties. But, as a result of a recent amendment, this provision also is enforceable through a private right of action.⁹⁸ Still, the law is limited in other ways: it applies only to nonclerical work performed by workers engaged by labor services agencies and extends liability only to purchasing client firms – that is, only to firms in contractual privity with labor suppliers.⁹⁹

In addition, like California, New York recently extended liability to downstream purchasers for wage and hour violations committed by garment industry subcontractors.¹⁰⁰ However, New York's mandate, like the Illinois act, is privately enforceable.¹⁰¹ The provision's key limitation is that it is duty-based. In other words, rather than making a purchasing firm a "guarantor" of or otherwise strictly liable for subcontractors' employee wages, plaintiffs or regulators must establish that the purchasing firm was negligent in failing to discover the subcontractor's violations.¹⁰²

Similarly, California's recently enacted "brother's keeper" law holds user firms in certain low-wage industries responsible for subcontractors' wage and hour violations under a duty-based standard. It provides that "[a] person or entity may not enter into a contract or agreement for labor or services with a construction, farm labor, garment, janitorial, or security guard contractor, where the person or entity knows or should know that the contract or agreement does not include funds sufficient to allow the contractor to comply with all applicable local, state, and federal laws or

96. See generally CHRISTINA CHUNG ET AL., ASIAN PACIFIC AM. LEGAL CTR. OF S. CAL. & SWEATSHOP WATCH, REINFORCING THE SEAMS: GUARANTEEING THE PROMISE OF CALIFORNIA'S LANDMARK ANTI-SWEATSHOP LAW AN EVALUATION OF ASSEMBLY BILL 633 SIX YEARS LATER (2005), available at <<http://www.apalc.org/pdffiles/SWReportFinal.pdf>>.

97. See 820 ILL. COMP. STAT. 175/85 (2010).

98. See *id.* § 95 (reflecting a 2005 amendment to that Act).

99. See *id.* § 5.

100. See N.Y. LAB. LAW § 345-a (McKinney 2010).

101. See, e.g., *Zheng v. Liberty Apparel Co.*, 556 F. Supp. 2d 284, 296 (S.D.N.Y. 2008).

102. The statute provides that a manufacturer "who contracts or subcontracts with another manufacturer or contractor for the performance of any apparel industry service . . . and who knew or should have known with the exercise of reasonable care or diligence of such other manufacturer's or contractor's failure to comply with [wage and hour mandates] in the performance of such service shall be liable for such failure." *Id.* (internal quotations omitted).

regulations governing the labor or services.”¹⁰³ In other words, if a contacting firm negligently fails to uncover and thwart employment law violations apparent from its contractual dealings with its labor suppliers, it can be held liable.

The legislation’s aim is to deter purchasing firms from entering into labor supply arrangements that are, by their financial terms, likely to lead to underlying wage and hour and other work-law violations.¹⁰⁴ Correspondingly, it is designed to trigger more rigorous supply-chain monitoring practices.¹⁰⁵ To encourage contractors to put their contracts in writing,¹⁰⁶ the statute does contain a safe harbor – that is, a rebuttable presumption that a firm contracting for work in the enumerated industries is not acting in violation of the law if the agreement is reduced to writing and meets a few basic requirements.¹⁰⁷ Unlike the AB 633 and the FLSA’s hot goods provision, this mandate is both broad in scope, covering production of goods and services in a wide range of industries, and privately enforceable.¹⁰⁸

Still, despite these innovations, violations of wage and hour laws remain common in all three states.¹⁰⁹ To date then, none of the extensions of responsibility beyond the traditional reach of employment mandates has achieved substantially greater compliance.

Building on the conceptual underpinnings of the hot goods provision, the recently enacted duty-based regimes at the state level, and third-party liability analogues elsewhere in the law, Professor Rogers recently argued for a broad duty-based approach to accountability for wage and hour violations. He contends end-user firms ought to be liable for failing to exercise reasonable care in preventing wage and hour violations in their domestic supply chains regardless of whether they have contractual relationship with the primary wrongdoer (i.e. the first-party labor supplier).¹¹⁰ In so doing, he offers a detailed account of the phenomenon of outsourcing, the history of the FLSA and problems of “employment” coverage limitations and enforcement, and the instrumental and normative

103. CAL. LAB. CODE § 2810(a) (West 2009).

104. Zatz, *supra* note 15, at 54.

105. *See* Weil, *supra* note 6, at 238-56.

106. *See* Victor Narro, *Impacting Next Wave Organizing: Creative Campaign Strategies of the Los Angeles Worker Centers*, 50 N.Y.L. SCH. L. REV. 465, 506 (2005).

107. *See id.* at 506-07 (these requirements include disclosing the basic material terms of the contract, the contractor’s state tax identification number, the contractor’s workers’ compensation and vehicle liability insurance policy, and the wages to be paid to individuals employed by the contractor).

108. *See id.* at 507.

109. *See generally* BROKEN LAWS, *supra* note 6.

110. Rogers, *supra* note 6, at 33.

arguments in favor of extending liability to third-party commercial purchasers who negligently fail to prevent upstream violations. Along the way, he also considers the possibility of imposing strict liability on such actors, noting that some potential objections may be overcome – e.g., the moral hazard such a regime might create for subcontractors and concerns about how far liability might extend – but ultimately concludes that strict third-party liability is inconsistent with prevailing legal norms and not politically feasible.¹¹¹

Rogers' article is a substantial contribution to the field. Drawing on both theory and the realities of modern enterprise structures, he makes a powerful case for third-party liability and why his negligence-based approach would be both fair and cost-efficient.¹¹² Many of his conclusions are consistent with mine, and I agree that the regime he proposes, like the more limited state-level reforms that have adopted privately enforceable, duty-based regimes, would represent a step forward in addressing the consequences of disaggregation. In some circumstances, his approach would create incentives for downstream firms to implement monitoring mechanisms and other measures to reduce the probability of upstream violations by labor suppliers and thereby deter some such violations. By extending accountability to negligent, adequately capitalized downstream actors, it also would result in recovery for some victims otherwise left uncompensated in an employer-focused liability regime.

Nevertheless, in my view, a duty-based approach is likely to fall short in key respects. While it removes the coverage barriers that contribute to inadequate enforcement under existing law, it replaces them with new hurdles for plaintiffs and regulators to overcome to establish liability. Except when carelessness in oversight is obvious,¹¹³ negligence, like exacting control, is a fact intensive, case-by-case inquiry. Indeed, Rogers suggests that, in assessing whether a purchasing firm has acted with reasonable care to ensure goods and services were produced in compliance with wage and hour laws, judges or juries should determine 1) whether the firm had actual or constructive notice of potential violations, 2) how much power the firm had to deter such violations, and 3) whether the firm took

111. *See generally id.* at 38-40, 47-49.

112. *See generally id.* at 33-61.

113. This might include, for example, an end-user firm's purchase of products or services that are priced so low that the supplier obviously cut corners on labor costs, or when such a firm is on notice of the supplier's existing violations or record of noncompliance and fails to take any meaningful steps to assure they are corrected. I would suggest, however, that these circumstances are atypical, even within industries in which wage and hour violations are common (unless courts would be willing to infer unreasonableness from purchasing at ordinary prices).

appropriate steps to do so.¹¹⁴ Rogers notes that this inquiry would be fact sensitive, and he goes on to describe the various factors to be assessed in answering each of the forgoing questions.¹¹⁵ He acknowledges administrability concerns (with the added wrinkle of apportioning fault), but most of his suggestions for mitigating measures – including firm exemptions and safe harbors – are aimed at reducing uncertainties for firms.¹¹⁶ For workers’ representatives and regulators, having to establish negligence, like having to establish exacting control, would interpose significant uncertainty and litigation costs.¹¹⁷

Moreover, judges are likely to be as or more uncomfortable with extending liability beyond its traditional bounds of employment as they have been in accepting the broad “economic realities” approach and therefore might resist inferring unreasonableness on the part of actors more than one step removed from underlying violations. Similarly, the critique of duty-based approaches to entity liability, such as those criticizing the affirmative defense to supervisor sexual harassment established in *Burlington Industries, Inc. v. Ellerth*¹¹⁸ and *Faragher v. City of Boca Raton*,¹¹⁹ applies with equal force here. Judges, subject to cognitive biases in making *ex post* assessments or other influences, and uncomfortable with extending liability for such bad acts to another, less culpable party, may find “cosmetic compliance” measures that are facially consistent with industry practices adequate, even though they are ineffective in preventing underlying violations.¹²⁰ They also may be deeply skeptical of claims of

114. Rogers, *supra* note 6, at 49.

115. *Id.* at 50.

116. *Id.* at 54-55.

117. This would be true even if there were a shift in the burden of persuasion to firms to show due care, as Professor Rogers suggests might be appropriate in some circumstances. *See id.* at 54. As a practical matter, workers and regulators would have to come forward with evidence of actual or constructive notice of underlying violations in response to a firms’ prima facie evidence of monitoring and other compliance efforts. And, as discussed below, even if they do, courts still might be skeptical of such claims. *See infra* note 120 and accompanying text.

118. 524 U.S. 742 (1998).

119. 524 U.S. 775 (1998).

120. *See* Melissa Hart, *The Possibility of Avoiding Discrimination: Considering Compliance and Liability*, 39 CONN. L. REV. 1623, 1642-46 (2007) (discussing the sizable literature calling into question whether employer compliance programs in response to *Faragher* and *Ellerth* and similar legal incentives actually reduce workplace stereotypes and discriminatory behavior); *see generally* Susan Bisom-Rapp, *An Ounce of Prevention is a Poor Substitute for a Pound of Cure: Confronting the Developing Jurisprudence of Education and Prevention in Employment Discrimination Law*, 22 BERKELEY J. EMP. & LAB. L. 1 (2001); Susan Bisom-Rapp, *Bulletproofing the Workplace: Symbol and Substance in Employment Discrimination Law Practice*, 26 FLA. ST. U. L. REV. 959, 967-76 (1999); Susan D. Carle, *Acknowledging Informal Power Dynamics in the Workplace: A Proposal for Further Development of the Vicarious Liability Doctrine in Hostile Environment Sexual Harassment Cases*, 13 DUKE J. GENDER L. & POL’Y 85 (2006); Joanna L. Grossman, *The Culture of Compliance: The Final Triumph of Form Over Substance in Sexual Harassment Law*, 26 HARV. WOMEN’S L.J. 3 (2003);

constructive notice where end-user firms have sought commonly utilized contractual assurances of compliance with labor suppliers, can point to standard monitoring measures that revealed no violations, or are several steps removed from the violating firm. Rogers acknowledges these concerns,¹²¹ but I believe they are more likely to dampen deterrence and enforcement.

Indeed, as a result of the avoidance opportunities that will emerge, enterprise structures will migrate toward those arrangements providing safe harbor at low cost – that is, the least costly contractual and monitoring practices likely to withstand judicial scrutiny for reasonableness. This is akin to the kind of “Whac-a-Mole” phenomenon we have observed elsewhere: at a general level, it is reflected in broad-based innovation around control-based “employer” accountability; it is also apparent in the development of outsourcing arrangements post-*Corporate Express*, which facilitated FedEx’s avoidance of employer status under labor law’s entrepreneurialism framework.¹²² In a duty-based regime, both end-user firms and their suppliers will have powerful incentives to adapt their practices and structures to minimize the probability of enforcement at any level of the enterprise. This will place many violations beyond the scope of accountability for end-user firms, or at least make liability highly improbable.

The overall result will be, once again, heavily discounted settlements and many unprosecuted claims, particularly at the very bottom of the labor market where compensation levels limit damage awards anyway. Furthermore, where an end-user firm is found to be in compliance with the standard of care but the labor supplier is insolvent, victims will be denied compensation. Some subset of egregiously careless end-user firms will be held to account, and this might have ripple effects, convincing others to fall in line.¹²³ But many outsourcing firms will continue to face insufficient liability risks to counteract the benefit they receive from labor at a price discounted by the lower probability of enforcement against the smaller firms from whom they purchase goods and services.

Kimberly D. Krawiec, *Organizational Misconduct: Beyond the Principal-Agent Model*, 32 FLA. ST. U. L. REV. 571, 577-80, 595-96 (2005).

121. Rogers, *supra* note 6, at 40.

122. *See supra* Part III.A.

123. *See* Rogers, *supra* note 6, at 54-55.

IV. A WAY FORWARD? TAKING THE “EMPLOYER” OUT OF WAGE AND HOUR LAWS

Because the causes are many, no single reform will resolve the problem of underenforcement of wage and hour laws at the low end of the labor market. Command-and-control regulation and greater unionization will not be effective alone. Given the vastness of the low-wage labor force, the resources for public enforcement will never be adequate, and, even if the long-term decline in union density is reversed, much of the workforce is likely to remain non-unionized.¹²⁴ Moreover, private enforcement undertaken on behalf of workers by the plaintiffs’ bar and advocacy organizations cannot fill the entire gap.¹²⁵ Nor can extra-legal mechanisms based on reputation and consumer pressure.¹²⁶

Still, the noncompliance-enhancing effects of disaggregation could be reduced – and significantly so – by *decreasing* the regulatory cost avoidance that visible, well-capitalized firms achieve through outsourcing, and, correspondingly, *enlisting their help* in preventing supplier firms’ violations. Achieving substantially greater deterrence and, relatedly, increasing the probability of adequate compensation for victims of violations requires more than modest expansions, such as altering the definition of “employer” or adopting limited exceptions to employer-based coverage. And, for the reasons discussed above, even bolder reforms, such as adopting a duty-based approach to third-party liability, do not go far enough.

Accountability must be extended further – much further. Avoidance of employer status is not merely a by-product of enterprise disaggregation: it is among the principal forces driving the phenomenon. Thus, I suggest that, at least in the wage and hour context, the most promising way to counteract the consequences of disaggregation is to eliminate the “employer” coverage limitation altogether.

In this article, I offer a proposal: commercial actors ought to be strictly liable for wage and hour violations in the production of any goods and services they purchase, sell, or distribute, whether directly or through intermediaries. In other words, accountability would no longer be tied to control, nor would liability for nonemployers (third-parties) be limited by fault. The key, indeed only, limitation is that a firm would be jointly and severally liable only for the portion of the violations attributable to the

124. See, e.g., Estlund, *supra* note 2, at 680-81.

125. See *id.* at 680.

126. See *id.* at 691-92 (stating that without the pressure of liability, such mechanisms are too weak and too limited).

goods or services it purchases, sells, or distributes.¹²⁷

Again, I will leave to a later article a more complete exploration of the justifications for such an approach. I also will set aside for now the threshold question of whether a worker must be an “employee” of some firm (rather than an independent contractor) to trigger protection under such a regime,¹²⁸ as well as questions of whether it ought apply extraterritorially and extend to labor and employment law mandates beyond the wage and hour context. Here, I will simply focus on some key attributes of this kind of approach and discuss likely consequences.

The resulting regime would be as it sounds: one imposing true enterprise liability in which commercial actors would be accountable regardless of the nature or proximity of their relationship with the noncompliant firm or the victimized workers. Indeed, purchaser, seller, and distributor status would need to be construed very broadly to avoid migration toward structures and practices that thwart enforcement. For example, purchasers of goods and services would include outright purchasers, lessees, holders of consignments, and possessors of goods as an intermediary or retailer for sale or resale. Likewise, sellers and distributors of goods and services would include outright sellers, lessors, distributors, intermediaries, retailers, or any other commercial actor who facilitates a sale or lease for an economic benefit, including through a consulting or intermediary arrangement, parent-subsidiary structure, franchising, licensing of a trademark or name, or providing retail space or online trading facilities.¹²⁹

127. A firm will be jointly and severally liable with others in the commercial chain, but again, only for the portion of the violations attributable to the products or services it purchases, sells, and distributes. For example, suppose manufacturer *A* sells its products to distributor *B*, and *B* evenly distributes the products to commercial purchasers *C*, *D*, and *E*. If *A* failed to pay its line workers the minimum wage, *B* would be jointly and severally liable along with *A* for 100 percent of the violations. *C* would be jointly and severally liable (along with *B* and *A*) only for its third of the violations. *C*, *D*, and *E* therefore would not be jointly liable at all; their liability vis-à-vis each other would be several. Certainly, the regime could include a right to indemnification from actors positioned closer to the violation – thus, here, *B* could seek indemnification from *A*; and *C*, *D*, and *E* could seek indemnification from *B* and *A*. But, as I discuss below, much of this is likely to be worked out anyway through private ordering.

128. Again, under current law, a worker who is an independent contractor is not entitled to the protections of the FLSA and most state wage and hour mandates. *See supra* note 31 and accompanying text. Because it is a separate (albeit related) question from the one I address here, I will leave to another day whether wage and hour protections ought to extend to true independent contractors. It is worth noting, however, that in most circumstances, low-skilled work is subject to supervisory coordination and control, and, hence, low-wage workers clearly are employees of *someone*. Thus, while the employee/independent contractor distinction will be an important issue in some low-wage contexts, such as in the delivery driver cases discussed above, in many other circumstances, it would not impose a barrier to enterprise liability.

129. To be clear, sellers and distributors would not be liable for wage and hour violations committed by downstream firms that have purchased their goods or services outright, unless such

Other factors that lead to underenforcement of wage and hour laws at the low end of the labor market will remain, as would other powerful incentives (beyond wage and hour mandates) to disaggregate. Yet because the proposed regime would extend accountability to all purchasers, sellers, and distributors regardless of control, it would reduce significantly the wage-related liability-risk discount from outsourcing work to third parties.

Perhaps ironically given the amount of noncompliance, violations of wage and hour laws are among the easiest in labor and employment law for regulators and workers to establish, since the substantive mandates are relatively straightforward.¹³⁰ Establishing liability is made uncertain and costly by the coverage limitations discussed above. By stripping out coverage as a pre-requisite to recovery, this uncertainty and the litigation costs associated with proving “employer” status would be eliminated. So too would the unpredictability and costs of establishing third-party liability under duty-based approaches, as well as safe harbors and cosmetic compliance barriers to liability that might emerge from judicial application. The only burden my proposal would add for workers – that is, in addition to the requisite showing of a violation – is demonstrating the portion of the violation attributable to the target firm. But this is something that often will be easy to show through examination of the violating firm’s records or the records of the purchasing firm(s).¹³¹

This, combined with the increased probability of a solvent defendant will increase the likelihood of private enforcement as well as the sting of public enforcement. Where violations are easily established, defendants will have limited leverage to demand discounted settlements. Moreover, claims never brought because the costs and uncertainty associated with establishing coverage or breach of due care would become viable.¹³² And, of course, opening up enforcement through extending liability to additional, more likely solvent firms will go a long way toward assuring adequate compensation.

sellers and distributors benefit directly or indirectly from the downstream firms’ further commercial activities (such as through a distribution, franchising, licensing, parent-subsiary, retailing, or other arrangement).

130. See Estlund, *supra* note 37, at 347 (stating liability and damages often are readily provable under federal and state wage statutes). Certainly, there are both conceptual and evidentiary complications in establishing some types of violations, most notably in the overtime context. However, in the run of cases, particularly minimum wage cases, the underlying obligations – and proving they were violated – are relatively straightforward.

131. See Rogers, *supra* note 6, at 54 (making a similar point about identifying downstream actors).

132. This regime might also facilitate enforcement by allowing for greater aggregation of claims. For example, workers employed by a number of small, independent contractors may be able to consolidate their claims against the general contractor who outsourced all of the work. The ability to aggregate might increase the probability of plaintiffs’ counsel prosecuting the claims.

Indeed, uncertainty would cut in the victims' favor. Strict liability will ensure no coverage- or duty-based discount, but, with the corresponding extension of wage and hour laws' remedial provisions, the failure of a target firm to exercise good faith in seeking to prevent violations may result in liquidated damages.¹³³ In other words, assuming the underlying violations are established, the bulk of the risk of uncertainty will be borne by defendants in the damages inquiry. This is, in essence then, a kind of extended composite liability regime – providing baseline strict liability with enhanced penalties for fault – that scholars have suggested best incentivizes firms to monitor for and prevent violations.¹³⁴

Obviously, there will be a number of objections to this proposal, most of which I believe will fall into three general categories. The first is that this kind of liability regime will result in more production being shipped overseas. Certainly, some additional outsourcing across international borders might occur. But, of course, this would be the result of any legal reform that makes enforcement of domestic wage and hour laws more effective, and, hence, increases the cost of labor to or above the level compliance demands. Thus, this critique is, in effect, simply another argument against wage laws themselves, which require effective enforcement to be meaningful.¹³⁵ As I stated at the outset, this debate is beyond the scope of this essay. Still, it should be noted that much of the low-wage work that would be affected by this kind of reform – including construction, janitorial, landscaping, agricultural, cleaning, food, retail, and delivery services, as well as time-sensitive manufacturing and assembly work – cannot be shipped overseas, and much of what can migrate easily elsewhere is already gone.

A second concern is that this kind of enterprise regime misallocates legal accountability by extending it to parties who cannot bear the risk efficiently, and, hence, would impose excessive compliance costs. For example, distant commercial actors unaware of upstream wage violations and facing severe information costs in discovering and avoiding such

133. For example, the FLSA provides that any employer who violates the wage and hour provisions “shall be liable to the employee or employees affected in the amount of their unpaid minimum wages, or their unpaid overtime compensation . . . and in an additional equal amount as liquidated damages.” 29 U.S.C. § 216(b) (2006). The court may award lesser or no liquidated damages if it finds that the employer's actions giving rise to liability were in good faith and that the employer had reasonable grounds for believing that his act or omission was not a violation. *See id.* § 260; 29 C.F.R. § 790.22 (2010). Prevailing FLSA plaintiffs are also awarded their reasonable attorneys' fees. *See* 29 U.S.C. § 216(b).

134. *See* Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 726-35 (1997).

135. *See* Rogers, *supra* note 6, at 59. It may also be an argument for some kind of extraterritorial application of enterprise liability, which is, again, a matter I leave for another day.

violations might nevertheless be held strictly liable for them. Put another way, one might imagine a resulting parade of horrors: Does such an extension mean that an engineering firm that purchases 10,000 pencils will be liable for wage and hour violations in the delivery of the logs to the mill that produced the wood that later went into the pencils? Would an occasional commercial client of a law firm be liable for the wage and hour violations at a small shop that provides much of the law firm's copying and delivery services?

The answers are, theoretically, yes and yes. But, as a practical matter, there is *very* little risk that these kinds of more distant and proportionately minor purchasers of goods and services will be targets for collection or subject to liability. Again, they will be jointly and severally liable only for the small portion of the violations attributable to their purchases.¹³⁶ The practical realities of litigation would steer public and private enforcement efforts toward *better-positioned* intermediaries – firms closer in the stream and therefore exposed to a greater portion of liability but also far more efficient cost avoiders, since they are more likely to know and be able to avoid or prevent violations.¹³⁷ These actors might include the mill, the lumber distributor, or the pencil manufacturer in the first scenario, and the law firm itself in the second.

Moreover, sometimes distant commercial actors *are* well- or even the best-positioned targets for enforcement. As an initial matter, such firms may be the principal cause of upstream noncompliance. For example, an exclusive retailer of finished lumber products purchased from upstream mills and distributors can demand low prices from these firms, who may respond by skirting wage laws to cut costs. If incentivized to ensure compliance, however, the retailer is also well-positioned to press these upstream firms abide by wage and hour laws (and to hire reputable delivery and other services), backstopped by the threat to take its business elsewhere. Similarly, a large local business that is a small law firm's principal client can demand below-market-rate services, which might press the firm to outsource copy and delivery functions to cheap (hence noncompliant) bidders. However, if concerned about liability, the business can push the law firm to take steps to ensure its service providers do not cut corners on wages, as well as adequately insure against such contingencies.

And this is the critical point: elimination of coverage barriers would

136. See *supra* note 127 and accompanying text.

137. Cf. Sykes, *supra* note 42, at 1232 (suggesting that third-party liability will be cost-efficient when the first party wrongdoer is likely insolvent and the third party is positioned to induce compliance by the first party); see also Weil, *supra* note 6, at 248 (discussing the effectiveness of stringent contractor monitoring in the garment sector).

prompt firms at serious risk of liability for wage violations to address their exposure *ex ante* through private ordering. These measures would include not only foregoing pricing and other practices that drive upstream firms to take shortcuts, but also utilizing only reputable suppliers and franchisees, bargaining for indemnification, and implementing mechanisms to monitor pay practices.¹³⁸ For example, in one study, stringent forms of contractor monitoring (induced by public pressure) in the garment sector – including unannounced inspections and reviews of payrolls – resulted in substantial reductions in minimum wage violations.¹³⁹ Firms would adopt a mix of such practices to protect themselves effectively and cost-efficiently, deploying different strategies depending on variables such as the costs of on-the-ground policing of others' work practices.¹⁴⁰

These kinds of steps also will counteract any moral hazard that might emerge among labor suppliers – that is, foregoing compliance since another firm will be the likely target of enforcement.¹⁴¹ Indeed, labor suppliers lacking adequate compliance records, sufficient capital or insurance, a demonstrated willingness to cooperate with others' monitoring efforts, and other indicia of being low-risk contractors for end-user firms will have difficulty competing for and keeping commercial customers.¹⁴² The net effect would be reducing violations through greater compliance efforts top-to-bottom in the enterprise.

Eliminating control-based coverage limitations therefore will spur enterprise self-regulation among larger firms by shifting firm risk management techniques from avoidance through outsourcing, which reduces compliance, to contracting, risk-spreading, and monitoring practices, which promote it.¹⁴³ And this regime is likely to produce other

138. Cf. Estlund, *supra* note 37, at 349 (in discussing the effects of hot goods enforcement against large, downstream manufacturers in the garment industry, stating that these manufacturers “in turn entered into agreements with their own contractors to abide by wage and hour laws, keep records, and submit to inspections by representatives of the manufacturers or by outside monitors”).

139. See Weil, *supra* note 6, at 248.

140. For example, policing costs might be high when the purchasing firm is unfamiliar with the supplier's specialized business. In such a circumstance, rather than seeking to monitor the supplier's on-the-ground practices itself, the purchasing firm might contract with an independent monitoring service that performs auditing and policing functions in the suppliers' industry. It might also demand certain practices and periodic reports on the supplier's compliance record; bargain for indemnification and insurance while keeping close watch on the supplier's financial position and maintenance of adequate insurance; and bargain for contractual provisions allowing for easy exit if, for one reason or another, the supplier becomes a source of too much liability risk.

141. See Rogers, *supra* note 6, at 38-39.

142. Labor suppliers therefore will have powerful incentives to avoid becoming known as violators. Although this might create some barriers to entry for small firms or entrepreneurs who have no pre-existing compliance record, this can be overcome through acceptance of contractual and monitoring conditions imposed by their commercial customers.

143. See Estlund, *supra* note 37, at 390 (noting that private litigation under wage and hour law can

compliance-enhancing consequences, including innovation in monitoring arrangements and technology, an increasing emphasis on reputation for compliance, better record-keeping, the creation of more sources of information on upstream practices, and the bolstering of upstream and downstream incentives to capitalize and insure.¹⁴⁴

Enterprise self-regulation and greater compliance itself will increase production costs. But goods and services ought to reflect the cost of mandated wages, and, by incentivizing well-positioned purchasers, sellers, and distributors to reduce violations, this regime will promote compliance efficiently.¹⁴⁵ Indeed, as mentioned above, firms at serious risk of liability will seek out cost-effective ways to address noncompliance elsewhere in the productive enterprise. Moreover, no additional public resources will be required, since this approach relies on *ex ante* self-regulatory efforts triggered by more effective *ex post* private and public enforcement.¹⁴⁶ Such reform alone may not turn the tide back toward vertical integration, but it will discourage more troubling outsourcing strategies that promote noncompliance.¹⁴⁷

A third kind of objection is that this proposal defies prevailing norms for allocating legal responsibility, and, for this and other reasons (including that powerful business interests will line up against it), it is unlikely to fare well with legal decision makers. As Professor Rogers suggests, this approach would run counter to a number of prevailing liability norms, including that the reach of tort-like statutory duties rarely are enterprise wide; there is general preference in modern American law for duty-based approaches; third-party liability normally is fault based; and, when there is third-party strict liability, it is almost always linked to control.¹⁴⁸ It would also extend an “employment” obligation beyond our social understanding of the employment relationship.¹⁴⁹

unleash self-regulatory reforms).

144. Cf. Estlund, *supra* note 2, at 690 (suggesting that if a firm like Nike can monitor working conditions at its hundreds of suppliers in dozens of countries, firms can develop mechanisms for monitoring their domestic contractors).

145. See *id.* at 689-90, 692 (discussing how end-user firms already have developed sophisticated self-regulatory systems, how these systems will cost less than public enforcement, and why the increased cost of labor that meets minimum standards is a social benefit, not a social cost).

146. Cf. Estlund, *supra* note 37, at 349-50 (noting that hot goods embargoing of goods can generate a system of private enforcement – throughout the chain of interconnected, independent entities – that is far more vigilant than public enforcement alone).

147. Professor Rogers argues that third-party liability might lead to re-integration in some industries. See Rogers, *supra* note 6, at 59.

148. See generally *id.* at 41-49.

149. See generally Noah D. Zatz, *Working at the Boundaries of Markets: Prison Labor and the Economic Dimension of Employment Relationships*, 61 VAND. L. REV. 857, 937-42 (2008) (discussing the social understanding of employment).

Still, there are existing models on which to draw. Two outside of employment law are the nondelegable duty doctrine¹⁵⁰ and products liability. Indeed, like my proposal, products liability law extends strict liability through multiple intermediaries in the commercial chain.¹⁵¹ Although both are imperfect analogies,¹⁵² the extension of accountability under these doctrines is undergirded by premises similar to those presented here – the third-party targets of strict liability are well-positioned to avoid serious social harms that might otherwise be difficult to prevent.

Yet the strongest conceptual basis in existing law for this approach comes from the FLSA itself: the hot goods provision. Again, when the FLSA was originally enacted, law makers included this provision because they recognized the role actors in the broader commercial enterprise play in incentivizing and facilitating violations.¹⁵³ They understood that allowing these other actors to benefit from the sale or use of goods produced in contravention of wage and hour laws produces unfair competition – because they can undercut others purchasing goods produced in compliance with the law – and is akin to trading in contraband.¹⁵⁴ Relatedly, they saw that effective enforcement sometimes requires focusing regulatory efforts on actors other than employers and these efforts can be leveraged to alter upstream behavior. Indeed, as Craig Becker has described it, the hot goods provision “might be thought of as the mirror image of product liability law, with the trajectory of the liability reversed.”¹⁵⁵

Certainly, what I propose would extend enforcement well beyond the existing hot goods provision, but the underpinnings are the same (actors and incentives in the broader enterprise affect wage and hour compliance within firms) and have been there since the beginning. Given what we now know – about the centrality of labor costs and wage laws in promoting outsourcing, the limits of public enforcement, the need for robust remedies, the incentives necessary to support private enforcement, and the shift in our

150. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS §§ 416-25 (1965) (discussing the various circumstances in which a non-delegable duty would be imposed on a party).

151. *See, e.g.*, Becker, *supra* note 12, at 1554 (noting this parallel between products liability and the FLSA’s hot goods provision).

152. *Cf.* Rogers, *supra* note 6, at 42 (concluding that products liability is a fairly weak analogy for third-party wage liability in part because manufacturers exercise greater control over production processes than downstream purchasers of services exercise over suppliers’ wages).

153. *See supra* note 81 and accompanying text.

154. *See supra* notes 81-82 and accompanying text.

155. Becker, *supra* note 12, at 1554. He went on to explain:

Under product liability law, courts extend responsibility for defective products back from the ultimate consumer to the producer, departing from the limiting principle that the parties in a warranty action must be in privity of contract. Under the hot goods provision, liability is extended forward from the producer toward the ultimate consumer.

Id.

economy toward the provision of services – my proposal could be viewed as a “hot goods and services” regime retooled for the twenty-first century.

Whether such a proposal is politically feasible is another matter. Certainly, there are reasons to believe it is unlikely at the federal level in the near future. Still, while increases in the minimum wage always are controversial, minimum wage protection itself continues to enjoy wide public support.¹⁵⁶ Recent innovations at the state level suggest that this support for the substantive mandate may extend to enforcement measures like the kind of approach suggested in this article – that is, one that bolsters enforcement and compliance without increasing government expenditures – at least in some jurisdictions. Moreover, these developments, the rising sense of frustration they reflect, and the growth of low-wage work and an ever-widening gap in income suggest the possibility of a groundswell of support for broad-based reform.

V. CONCLUSION

Employer-based limitations on legal responsibility help drive firm disaggregation. The fragmented enterprises that result pose significant challenges for enforcement of wage and hour mandates – challenges that were foreseen by the FLSA’s proponents, have grown over time, and are likely to become more pronounced in the future. Although no single legal reform will fully address the problem, recalibrating legal responsibility to reflect the realities of disaggregation could have a profound impact. But this will take more than modest expansions of the definition of “employer” or restricted forms of third-party liability. It requires removing employer-based limitations altogether. As I have argued here, this can be achieved by extending strict liability for violations to commercial purchasers, sellers, and distributors of goods and services. Such an approach would substantially decrease the regulatory cost avoidance well-capitalized firms achieve through outsourcing and would press them into utilizing their self-regulatory capabilities to prevent supplier firms’ violations. This kind of reform is not only consistent with the normative premises underlying the FLSA, but also essential for promoting decent work in a post-Great Recession world.

156. See, e.g., ROBERT P. JONES & DANIEL COX, RELIGION AND THE TEA PARTY IN THE 2010 ELECTION: AN ANALYSIS OF THE THIRD BIENNIAL AMERICAN VALUES SURVEY 23 (2010), available at <<http://www.publicreligion.org/objects/uploads/fck/file/AVS%202010%20Report%20FINAL.pdf>> (finding that more than two-thirds of Americans support increasing the minimum wage from \$7.25 to \$10.00 and that support extends across partisan and religious lines).