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Oil and Gas Alert: Pros and Cons: Use of Independent Contractors in the Oil and Gas Industry

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Daniel J. Clark

Thomas H. Fusonie

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The use of independent contractors in the oil and gas industry is typical and its advantages are obvious. However, decisions about when and how to use independent contractors might be made without full consideration of potential problems or the ever-looming and potentially significant risks of misclassification.

Like other industries, the oil and gas industry is under constant scrutiny from the U.S. Department of Labor and investigators from the states in which oil and gas companies operate. In addition to fines and citations issued by governmental agencies, collective actions alleging violations of the Fair Labor Standards Act have exploded in number, and are now more common than employment discrimination cases.

While the use of independent contractors remains a useful tool for oil and gas companies, human resources and legal professionals within these companies should weigh both the pros and cons associated with their use.

Pros:

1. **Avoid Costs of Employee Benefits.** Fringe benefits for an employee often add up to 20-50% of the amount paid to an employee as wages. Keeping a newly hired contractor off the company's health insurance or pension plans can provide easily identifiable savings.
2. **Reduce Tax Liabilities.** Federal payroll taxes add to an employer's costs for each new employee hired, but are expenditures rarely appreciated by employees. Additionally, workers' compensation and unemployment premiums can be avoided through the use of independent contractors. By avoiding these added costs, companies can often pay contractors more than an employee without increasing the employer's costs.
3. **Flexibility.** When utilized properly, independent contractors enhance a company's ability to quickly respond to shifting business needs. A contractor can provide a specialized skill or service that is needed only occasionally or performed remotely. For example,

companies may elect to retain well tenders or land agents as independent contractors to monitor particular wells or to secure land rights for specific projects. These arrangements allow for local contractors to be used on tasks that require a particular skill set in a location where the company does not desire to have local employees.

Cons:

1. **Risk of Misclassification.** Under increasing scrutiny from regulators and plaintiff's lawyers, a decision to use independent contractors should be made only after acknowledging the risks of misclassification. Agencies such as the Internal Revenue Service, the Equal Employment Opportunity Commission, and most recently the National Labor Relations Board, will investigate and often challenge a company's classification of an independent contractor. The tests applied by these agencies can vary and are fact specific. More problematic is the reality that relationships that look like contractor relationships at the outset often shift toward employer-employee relationships, making it often difficult to be completely confident that a contractor is properly classified.
2. **Loss of Workers' Compensation Coverage.** Although workers' compensation premiums represent an added cost for companies hiring employees, workers' compensation coverage also protects the employer should an employee be killed or injured on the job. While an independent contractor agreement may provide some protections, any company should consider the risks of the lack of workers' compensation coverage.
3. **Loss of Control.** To be properly classified as an independent contractor, the contractor and not the employer must control the manner in which the work is performed. Contractors are often permitted to determine when and how work is performed and even to hire assistants or subcontractors to get the work done. A company seeking to exercise more direct control over the work being performed may need to accept that it will need to utilize its own employees. Companies exerting or seeking to exert too much control over a contractor frequently result in findings of misclassification.
4. **Other Considerations.** Since independent contractors may work at company facilities or have access to a company's electronically stored information, companies must take reasonable steps to protect their trade secrets and confidential proprietary information. Likewise, companies need to take steps to avoid independent contractors engaging in discrimination, harassment or interference of company employees' employment rights.

Independent contractors are a useful and common tool for companies where flexibility and specialized skills are highly valued. However, given the potential cons associated with the use of independent contractors, companies in the oil and gas industry should be aware of situations where it might make more sense to assign work to an employee or to re-evaluate an existing contractor relationship.

If you would like assistance in evaluating your use of independent contractors, contact Daniel Clark (614.464.6436 or djclark@vorys.com) or Tom Fusonie (614.464.8261 or thfusonie@vorys.com).