Work for Hire Language Makes Independent Contractor an Employee

By June Lin

Introduction

Imagine a company that works with a variety of independent contractors based in California - for example, software engineers creating software for the company's products. In its standard form agreement with its contractors, the company has the following intellectual property provisions: "The parties expressly agree that Contractor's work under this Contract shall be considered work made for hire for Company as such term is defined in Section 101 of the Copyright Act of 1976, to the extent Contractor, in performing this Contract, produces new work product, including without limitation notes, reports, documentation, drawings, computer programs (source code, object code and listings), derivatives of pre-existing copyrighted works of Contractor, customer lists, inventions, creations, works, devices, masks, models, work-in-progress, and deliverables ("Work"), and all such Work shall be the property of Company. Accordingly, Company shall be the proprietor of the Work and of all rights therein throughout the world including, without limitation, the copyright and all rights under copyright therein, and the specific right of reproduction provided in California Civil Code Section 982. Contractor further hereby agrees to assign and does hereby expressly assign to Company all right, title, and interest, including without limitation all rights under copyright, in and to the Work."

The company, assuming these independent contractors are not employees, does not pay any state employee payroll taxes relating to the contractors. The California Employment Development Department audits the company and assesses it for Personal Income Tax, Unemployment Insurance and Disability withholdings and related penalties amounting to about $100,000 because the company failed to pay employee payroll taxes in relation to these

contractors. True story? Yes – in fact this was one of our firm's clients (although our firm did not draft the independent contractor agreements!)

What is a Work Made for Hire?

A "work made for hire" (sometimes abbreviated as "work for hire") is an exception to the general rule that the person who actually creates a work is the legally recognized author of that work. According to U.S. copyright law, when a work is created by an employee as part of his or her job, or when certain kinds of works are created on behalf of a client and all parties agree in writing to the designation, a work may be a "work made for hire". If a work is made for hire, the person or entity that hired the actual creator of the work is considered the legal author of the work.

California's View on Work Made For Hire

Under California law, a party transferring rights to any work made under an agreement for hire is an employee for purposes of workers' compensation and unemployment insurance. The Employment Development Department of the State of California ("EDD") has taken the position that "work made for hire" language included in an agreement that otherwise provides for consultant or independent contractor services, nonetheless renders the contractor a statutory employee.

As support for its position, the EDD references California Unemployment Insurance Code Sections 686 and 621(d) and California Labor Code Section 3351.5(c), which provide as follows:

Cal. Unemp. Ins. Code Section 686:

> *" 'Employer' also means any person contracting for the creation of a specially ordered or commissioned work of authorship when the parties expressly agree in a*

written instrument signed by them that the work shall be considered a work made for hire, as defined in Section 101 of Title 17 of the United States Code, and the ordering or commissioning party obtains ownership of all of the rights comprised in the copyright in the work. The ordering or commissioning party shall be the employer of the author of the work for the purposes of this part." (emphasis added)

Cal. Unemp. Ins. Code Section 621(d):

" 'Employee' means all of the following:… (d) Any individual who is an employee pursuant to Section 601.5 or 686."

Cal. Lab. Code Section 3351.5(c):

" 'Employee' includes:… (c) any person while engaged by contract for the creation of a specially ordered or commissioned work of authorship in which the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire, as defined in Section 101 of Title 17 of the United States Code, and the ordering or commissioning party obtains ownership of all the rights comprised in the copyright in the work." (emphasis added)

It is interesting to note that Cal. Unemp. Ins. Code Section 686 and Cal. Lab. Code Section 3351.5(c) both appear to provide that the employer and employee status arise if and when the business actually obtains ownership of all the rights comprised in the copyright in the work. This raises the question of whether one can dispute the finding of employment in these types of relationship if the business decides not to use and/or claim ownership of the resulting work product, despite the existence of "work made for hire" language in the relevant agreement. Based on EDD's recent enforcement actions, the answer appears to be no, given the EDD has been known to assess companies for employee payroll taxes relating to contractors who never

actually created any work product that would be subject to the "work for hire" language in their agreements, including a contractor retained to be a financing consultant.

It is also important to note that although Cal. Unemp. Ins. Code Section 686 indicates that "the ordering or commissioning party shall be the employer of the author of the work for the purposes of this part" (which would seem to suggest only for the purposes of unemployment and disability insurance purposes), the EDD's recent enforcement actions indicate that once these provisions are triggered, the employer is liable not only for addressing the unemployment insurance and disability insurance issues, but also for the personal income tax of the author.

Unfortunately no relevant decisions by California courts have been rendered regarding these sections of the Unemployment Insurance and Labor Code, which makes it difficult to predict the likely outcome of a company's appeal of a final notice of assessment from the EDD in any given case.

These statutes create a potential conflict with the need for companies, in arrangements with contractors for the creation of intellectual property, to ensure that the company is deemed the initial author and exclusive owner of the resulting work product. It is common to include the "work made for hire" language in such contractor agreements to remove all potential for dispute on this issue and to prevent a need for additional paperwork or consents from the contractor, which can be the case where only an assignment of rights in the work product is used in the contractor agreement. The 2005 Ninth Circuit case *Twentieth Century Fox Film Corporation v. Entertainment Distribution*[1] illustrates the problem the contracting company may have if the work produced is not a "work for hire". In this case, Doubleday had convinced General Dwight Eisenhower to write his memoirs shortly after World War II. Eisenhower's tax advisors recommended that he should not produce a book under contract, but should write it and wait

[1] 429 F.3d 869 (9th Cir. 2005).

more than six months to sell it so he could get capital gains treatment. However, Eisenhower had extensive discussions with Doubleday about the book as he wrote it, and Doubleday provided extensive support, including round-the-clock secretarial support, researchers, etc., all without a written contract. Six months and a day after he finished the manuscript, Eisenhower sold it to Doubleday. Later Doubleday sold to Fox exclusive television rights to the book. Still later, Dastar created its own video documentary based on the book using extensive portions of the book as video narration without obtaining Fox's permission. Fox sued Dastar for copyright violation. Dastar's defense turned on whether the book was produced as a "work for hire". If it was a work for hire, the party contracting to have it produced owned it outright; at the expiration of the then applicable 28-year copyright term, that party would have the right to renew the copyright. However, if it was not a work for hire, but a mere assignment of rights, then at the end of the copyright term, only the creator of the work, or his/her estate, would have the right to renew the copyright. Ultimately the Ninth Circuit said in this case that the entire course of conduct between Eisenhower and Doubleday indicated that they intended this to be a work for hire and so Doubleday/Fox's renewal of the copyright would be recognized and Dastar was an infringer.

Interestingly, the *Twentieth Century Fox* court stressed that independent contractors such as Eisenhower could create "works for hire" as long as the works were created at the instance and expense of the commissioning party. There was no need for a written contract specifically stating the work was a "work for hire" as defined in the Copyright Act. Query whether the lack of a written "work for hire" provision saved Doubleday from being slapped with assessments by the California EDD.

Conclusion

Parties must be wary about entering into agreements with California individuals which they believe to be independent contractor agreements, only to find out later that the "work for hire" arrangement caused the relationship to be one of employer/employee. Few intellectual property and employment law attorneys in California are aware of Cal. Unemp. Ins. Code Section 686 and Cal. Lab. Code Section 3351.5(c) or their implications for an independent contractor relationship. Many California attorneys regularly recommend to their clients that they include the "work made for hire" language in every independent contractor agreement in order to secure ownership of all works created by such contractor during the course of his or her relationship with a company.

One way around this problem is to eliminate the "work for hire" provision, and have the contractor simply assign his rights to the company. An assignment of intellectual property rights largely accomplishes what most companies want to achieve. For most software and other works created for products to be released in the current market, the work's ownership more than 70 years [2] from now will not be critical, or even marginally relevant, to any business need. Another way around this problem, if the work for hire language is critical, is for the contractor to form an LLC and have the LLC contract to do the work. We now routinely advise our clients to take this approach. Even in California an LLC cannot be an employee. But if the contractor is an individual, and the contract provides for the creation of a work for hire, the contractor is by statute in California an employee.

This article is intended to provide a general summary and should not be construed as a legal opinion nor a complete legal analysis of the subject matter. June Lin is an attorney at Niesar & Vestal LLP in San Francisco, a law firm specializing in business law and corporate finance.

[2] The current copyright term is the life of the author plus 70 years.