EX-ANTE VS. EX-POST: OPTIMIZING STATE INTERVENTION IN EXPLOITIVE TRIANGULAR EMPLOYMENT RELATIONSHIPS

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I. INTRODUCTION

In the last two decades, labor markets and employment relationships have undergone a marked change.[1] Most industrial countries are transforming their economies, labor markets, and industrial relations into more flexible and less regulated regimes.[2]

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1. *See, e.g.*, RICHARD S. BELOUS, THE CONTINGENT ECONOMY: THE GROWTH OF THE TEMPORARY, PART TIME AND SUBCONTRACTED WORKFORCE (1989); Thomas A. DiPrete et al., *Collectivist versus Individualist Mobility Regimes? Structural Change and Job Mobility in Four Countries*, 103 AM. J. SOC. 318 (1997); GOSTA ESPING-ANDERSON, THE THREE WORLDS OF WELFARE CAPITALISM ch. 8-9 (1990); Catherine Hakim, *Core and Periphery in Employers' Workforce Strategies: Evidence from the 1987 E.L.U.S. Survey*, 4 WORK EMPLOYMENT AND SOCIETY 157 (1990); Jeffrey Pfeffer & James N. Baron, *Taking the Workers Back Out: Recent Trends in the Structuring of Employment*, *in* RESEARCH IN ORGANIZATIONAL BEHAVIOR 257 (Barry M. Staw & Larry L. Cummings eds., 1988); GERRY RODGERS & JANINE RODGERS, PRECARIOUS JOBS IN LABOR MARKET REGULATION: THE GROWTH OF ATYPICAL EMPLOYMENT IN WESTERN EUROPE (1989).

2. For convenience purposes in this paper, I will define the decision to use temp agencies, subcontractors, or employee leasing as a decision to outsource parts of the production from one's company to external entities. While I am fully aware of the distinctions in the treatment of these different categories, the arguments made in this paper are more general in nature and hence should not be harmed by this broad definition. In accordance with this approach, I will differentiate between two types of employees: primary and secondary.

Triangular employment relationships are becoming increasingly vital to today's economy.[3] Outsourcing is now widely recognized for the competitive advantages it provides, as reflected in the rapidly growing rates of outsourcing around the world.[4] Many business functions are outsourced for various reasons:[5] to streamline processes, remove burdens, cut costs, etc. There are numerous identifiable forms of outsourcing, such as sub-contracting, employee leasing, and the use of temp agencies and service companies, as well as various integrated corporate networks and franchising techniques. The common denominator is a separation between the entity that consumes the services of the employee and the entity being defined by the parties as the "formal employer." This separation between the two entities creates an opportunity for employers to exploit the employment rights of these secondary employees. In many cases, the "formal employer" is an unstable business entity that tends to have a more limited respect for employment rights than the user entity. As the popularity of the triangular employment relationship increases, so does the unfortunate exploitation of secondary workers.[6] Awareness of this exploitation has led to several attempts by lawmakers to utilize legal intervention to regulate triangular employment relationships.

While secondary employees experience many hardships because of the triangular employment relationship, the various techniques of legal intervention designed to address them have consistently focused on a particular set of problems. They mainly seek to address the following three recurrent issues:

1. Fraudulent (or non-authentic) outsourcing relationship.[7]
2. Substantial inequality between secondary and primary employees.[8]

3. *See, e.g.*, Amira Galin, *Outsourcing, Organizational and Managerial Perspectives*, 7 ISR. LAB. L. ANN. REV. 43 (1999).

4. *See generally* Ruth Ben-Israel, *Outsourcing through Manpower Contractors*, 7 ISR. LAB. L. ANN. REV. 5 (1999); Guy Davidov, *Joint Employer Status in Triangular Employment Relationships*, 42 BRIT. J. INDUS. REL. 727 (2004).

5. The paper later analyzes the failures that emerge from the fact that multiple reasons could lead to outsourcing.

6. *See, e.g.*, Int'l Lab. Org. [ILO], *The Employment Relationship: An Annotated Guide to ILO Recommendation No. 198* (2007), *available at* http://www.ilo.org/public/english/dialogue/ifpdial/downloads/guide-rec198.pdf (for a discussion of some of the common weaknesses in employment relationships in general and in triangular relationship in particular).

7. That is, the main purpose of the outsourcing was to create opportunities for exploitation of these employees. As explained in more detail in the succeeding parts of the paper, there are two approaches to examine the business authenticity of a given transaction: objective and subjective. The subjective aspect verifies whether the transaction was not strictly for a legitimate business purpose; the objective aspect evaluates the nature of the relationship between the user enterprise and the employee in question.

8. That is, clarifying whether or not there are two separate employee classes in terms of employment benefits.

3. Non-provision of basic conditions to the secondary employees.[9]

An abundance of methods have developed to deal with these most common problems and ensure appropriate work conditions for secondary employees. For the most part, these techniques can be classified as stemming from either an ex-ante or ex-post approach. An ex-ante approach refers to a legal regime with clearly defined rules governing the treatment of secondary employees. In such a regime, courts receive limited discretion beyond deciding if a specific rule applies in the given circumstance. In contrast, an ex-post approach refers to a system of broadly defined standards regulating the treatment of secondary employees in triangular relationships. Courts are given wide discretion in deciding the nature of an employment relationship. While the approaches of the courts vary, there are three primary ex-post techniques employed by the courts around the world:

1. Attributing full employer status to the user enterprise instead of the formal employer.
2. Obligating equal treatment between primary and secondary employees who perform the same job.
3. Mandating shared employment relationship or shared responsibility for secondary employee conditions.

In contrast, in many continental law countries, the same problems are usually addressed from an ex-ante perspective, such as legislation listing permissible reasons for outsourcing, mandating equal pay for secondary employees, and limiting the length of employment.[10] Following is a brief delineation of the main ex-post techniques, including a short explanation of the specific problems that each of them addresses.[11]

A. Who Is the Employer?

This first and most common technique involves granting courts ample discretion to decide whether the transaction is legitimate. This method will receive the most attention in this article as it seems to enjoy the greatest popularity.[12] It is also instructive for examining the ability of the courts to

9. A fourth common problem, subcontract perpetuation (i.e., deciding if the period during which the subcontracting took place was too lengthy and hence should be considered exploitative), belongs in a class of its own for reasons described later on.

10. Such is the law in France and Belgium that have strict ex-ante limitation both on the length of time and on the reasons that justify using external employees. Furthermore, in these countries, there is a requirement for equal pay, which should be paid to those employees. *See* Sabine Smith-Vidal, *France*, 36 B.C. L. REV. 245, 251 (1999); Othmar Vanachter, *Belgian Report*, 36 B.C. L. REV. 201, 203 (1999).

11. There are some additional less used techniques. *See, e.g.*, Tamajo & Perulli, *supra* author note, at 64, (review of the various techniques).

12. *See generally id.*

provide ex-post protection of secondary employees without the assistance of strictly defined ex-ante rules.

This technique involves distinguishing between legal and pseudo-legal employee outsourcing by examining whether the user company's main motivation to outsource was unethical. Examples of unethical reasons include unjustified reduction in salary and benefits for secondary employees, avoiding provision of employee benefits, or circumventing collective agreements. In addition, multiple year relationships usually demonstrate that flexibility was not the true reason for the transaction. With some variation between countries, the legal remedy usually involves total imposition of employer responsibility upon the user corporation.[13] Furthermore, cross-state variation also seems to exist with regard to the type of sanctions courts can impose, ex-post, on fraudulent employers.[14]

A variety of tests are conducted to examine the true relationship between the user enterprise and the secondary employee to determine who should be seen as the employer. The evolution of the different tests that exist in U.S. law and the various interpretations that exist on how to use them, provide a good example of the complexity of determining the identity of the true employer in an ex-post regime.[15]

13. This is the law in countries such as Mexico, South Africa and Croatia. *See generally* Tamajo & Perulli, *supra* note 12, at 65.

14. While in some countries there is a distinction between legal and fraudulent worker contracting, requiring contracting companies to acquire formal governmental permission, the sanction for fraudulent procurement is a fine and shared responsibility for any debts, but not any imposition of a formal employment relationship. In order to preserve the financial and legal freedom of its companies, Canada rejects any sanction that would formalize the employment relationship between secondary employees and contracting companies; *see id.* For further discussion about the comparison between the United States and Canada, see Orly Lobel, *The Slipperiness of Stability: Contracting for Flexible and Triangular Employment Relationships in the New Economy*, 10 TEX. WESLEYAN L. REV 109, 133 (2003).

15. Indeed, in U.S. law, courts are mostly charged with creating and applying the tests for each one of the employment laws. For a review of the employment laws that do and do not apply to secondary employees see Stone, *supra* author note.

In attempting to identify the "true employer" in triangular relationships, U.S. courts have used the economic realities test to determine a formal relationship between a user employer and its secondary employees. In Rutherford Food Corp. v. McComb, 331 U.S. 722, 730 (1947), the Court found the owner of slaughterhouse facilities to be the true employer of workers it acquired through a third-party contractor. The subcontractor, Reed, retained complete control over his workers, while the Kaiser Packing Company in turn provided the necessary premises and equipment. *Id.* Thus, in finding that Kaiser should be considered the true employer under the FLSA, the Court did not limit itself to a common law control analysis, but rather examined the full circumstances of the triangular relationship. *Id.* at 726. In line with this analysis, the manner in which the secondary workers functioned as part of an "integrated economic unit" was found to supersede the negligible level of control the beef company actually retained over the workers. *Id.* at 725.

For a criticism on U.S. regulation with regard to secondary employees as well as on the inconsistency in using the Darden tests, see Stephan 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).

B. Joint Employer/Responsibility Status

A second technique many countries[16] have adopted involves imposing shared responsibilities on the user entity. This approach generally requires the user entity to serve as a guarantor for a set minimum of employee salaries and benefits. Because of the often-ephemeral lifespan of temp agencies, secondary workers can find themselves left without pay and no one to sue for lost wages. In light of this reality, many countries recognize the right of secondary workers to prove the existence of a joint employer relationship, where the primary employer would be responsible for paying the lost wages. A typical example of a joint employer regime can be observed in the United States.[17] However, in the United States, with regard to some of the laws, joint employer status is only imposed after an ex-post examination of the relationship between the employee and the user enterprise, or in situations where the formal employer has gone out of business.

A related but somewhat different approach rejects the imposition of full responsibility upon the subcontractor[18] in favor of the imposition of shared employer liability for secondary employee conditions.[19] Under this

16. The most prominent example may be seen in U.S. law. United States law utilizes the concept of co-employment to a certain extent. As mentioned above, there is a significant precedent in U.S. law for secondary workers attempting to prove the existence of a co-employment relationship as a means of receiving compensation from the user company in the event of agency bankruptcy. In addition, U.S. law does require the user company to uphold health and safety standards (OSHA) and prevent discrimination; for instance, in Boggs v. Blue Diamond Coal Co., 590 F.2d 655, 658 (6th Cir. 1979), the court found that employees of a subsidiary mining company could recover damages for injuries resulting from a parent company's negligence. In so holding, the court refused to allow the parent company to contravene its separate corporate existence as a means of invoking Worker's Compensation protections. *Id.* at 661. However in Mozeke v. International Paper Co., 856 F.2d 722 (5th Cir. 1988) in which a subsidiary employee sought negligence damages from a parent company as the owner of the premises on which injury occurred. In that case, the plaintiff was denied damages after the parent company was found to fall within the definition of "statutory employer" under Worker's Compensation. *Id.* "Employer" status was granted with reference to "operations as a whole," such that the injury, which occurred during the course of the defendant's normal business operations, did not provide grounds for alternate civil damages. *Id.* Another method that exists under U.S. law to prevent situations in which secondary employees are not paid for their work is provided in the Miller Act, 40 U.S.C. §§ 3131-3134 (2008), which requires a contractor on a federal project to deposit bonds to ensure payment. *See also* FINAL REPORT (Commission on the Future of Worker-Management Relations, 1995), *available at* http://www.dol.gov/_sec/media/reports/dunlop/dunlop.htm.

17. In 1973, the Supreme Court held that an employee can have more than one employer under the FLSA. Falk v. Brennan, 414 U.S. 190, 195 (1973) (finding apartment building owners and a maintenance company to be joint employers of maintenance workers despite contractual provision designating workers as employees of building owners). "Joint employers are responsible, both individually and jointly, for compliance with all of the applicable provisions of the [FLSA], including the overtime provisions." Torres-Lopez v. May, 111 F.3d 633, 638 (9th Cir. 1997). To find a joint employment, the agency looks at the extent to which both employers are involved in the employment activities. *Id.*

18. In certain instances, the responsibility is not full but rather focuses on some basic rights like health rights and the like.

19. Tamajo & Perulli point out that Japanese and Australian law are similar in that the subcontractor is the only "employer" responsible for his employees. *See* Tamajo & Perulli, *supra* author

type of relationship, if the user enterprise fails to provide for its subcontracted employees, the subcontractor will supplement the workers' benefits.

C. Ensuring Equality

The third common technique mandates equal treatment of primary and secondary workers. The legal function of this is to guarantee the rights of secondary workers, and to remove the cost-cutting incentive of outsourcing.[20] The aim in this approach is to distinguish between justified cost reduction, attributed to flexibility and specialization, and unjustified cost reduction by exploiting the arbitrary reduction of salary and benefits of secondary employees. There are several important caveats regarding the specific conditions under which this technique is applied. For example, the institution of inclusive equal treatment is questionable when the duties of primary and secondary workers are dissimilar. Moreover, where different employees are covered by separate collective agreements,[21] there is an obvious discrimination against temporary employees. Even if the duties are similar, unequal treatment may result from factors such as seniority, which tend to favor only primary employees.

D. The Argument

While the variety of techniques adopted by different countries is well documented, there have been limited attempts to compare the efficacy of these techniques either theoretically or practically.[22]

This article offers a new framework for analyzing the existing techniques that are supposed to prevent secondary employee exploitation—

note, at 20. There are virtually no laws that render the contracting company responsible for its secondary employees, except for certain state protections. In each of these countries, the contracting company is responsible for the health and safety of its secondary workers. Sweden emphasizes additional protections against discrimination. Japan, which has special Worker-Dispatching Laws, holds the user company responsible for equal treatment, working hours, vacation, days off, childcare hours, etc. Australian workers compensation legislation also mandates some kind of liability or insurance in the event that secondary employee wages are not met.

20. Leaving logistics, specialization, etc., as the only legitimate motivations for outsourcing.

21. In the United States, recent case law has made it nearly impossible for temporary employees to be in the same union with the primary employees. *See* Oakwood Care Center, 343 N.L.R.B. 659 (2004). The court stated that temporary workers could join together in their own unions although this can often be difficult because these workers rarely have constant contact with each other, which makes organization very difficult. *Id.* Hence, in that regard, there is a move in the direction of greater inequality between primary and secondary employees. *See also* Jeff Vockrodt, *Realizing the Need for and Logic of an Equal Pay Act for Temporary Workers*, 26 BERKELEY J. EMP. & LAB. L. 583 (2005), who discusses the *Oakwood* case and the need for an equal pay act for temporary workers. Vockrodt proposes an ex-ante solution to some of the issues that temp workers are facing.

22. *See* Davidov, *supra* note 4 for such an attempt.

classifying them along the ex-ante or ex-post dimensions.[23] The theoretical discussion of the optimal combination of ex-ante and ex-post intervention will uncover the relative strengths and weaknesses of the existing methods of regulating triangular relationships. It will expose the underlying values protected by the different techniques and their interrelation, and will demonstrate the inferiority of the ex-post approach. The article concludes with a demonstration of the particular areas where applying an ex-ante approach could supplement the business purpose test. I argue that the adoption of a single technique imposes unnecessary constraint on courts. Through an understanding of the limitations and relative advantages of ex-ante and ex-post regimes, the paper advocates an integrative approach that would combine the advantages of both.

The ex-post vs. ex-ante debate is mainly addressed by legal scholars, who use a different set of concepts to discuss similar questions related to the optimal specificity of the law. Kaplow's focus is on the cost associated with ex-ante framing versus gaining information on what to do in any given situation, ex-post.[24] When reality is complex and consists of many new circumstances, it is beneficial to create standards since the costs of framing rules for each of these situations would be prohibitive for the legal policymaker. Along those lines, Sunstein has written a multidisciplinary explanation on the strengths and weaknesses of rules.[25] Among the disadvantages is the relative ease with which rules may be circumvented. This fear is especially relevant in an employment law context, where employers are under pressure to cut their production costs by escaping as many of its "costly duties," as possible.

What is common to each of these approaches is that they all suggest a set of tools to decide whether to create clear ex-ante rules, or a broadly defined set of standards leaving the courts ex-post discretion in applying the standards. I will use these tools to analyze a method for optimizing legal intervention in protecting secondary employees.[26] The analysis will focus on some of the common types of exploitations secondary employees experience, while examining the most efficient way to curb them.

23. *See id.* at 4

24. *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992). A somewhat similar technique is offered by Christoph Engle, who essentially asserts that the law must be sufficiently flexible to deal with a reality that is inconsistent and dynamic. *See* Christoph Engel, *Inconsistency in the Law – In search for a Balanced Norm*, *in* IS THERE A VALUE IN INCONSISTENCY (Lorraine Daston & Christoph Engel ed., 2005).

25. *See* Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953 (1995).

26. An interesting parallel to the decision whether to use an ex-ante or an ex-post approach is evident in a related but different context of "who is an employee." In U.S. law, an interesting debate has emerged from the case of U.S. v. Lauritzen Farms, 835 F.2d 1529 (1987) where the dissenting opinion of Judge Easterbrook challenges the majority opinion for ignoring the costs associated with an ex-post approach to decide "who is an employee."

The comparative perspective—using both Israeli labor cases as well as a comparison of the continental and U.S. approaches—will help to contextualize the abstract arguments in a more realistic manner. Israel—having the highest ratio of temporary employees in all OCED countries[27]—presents an ideal illustration for such analysis because it has adopted, for the most part, a relatively pronounced ex-post approach and has recently examined the possibility of incorporating an ex-ante approach for regulating temp agencies.[28] The relationship between Israel's traditional extreme ex-post approach and that of the newer regulation is still debated, a fact that sharpens the pros and cons of ex-ante vs. ex-post interventions.

The paper's criticisms and recommendations of this approach can be applied almost universally, as many countries focus primarily on either ex-post or ex-ante approaches to prevent secondary worker exploitation. I will argue that if an intervention could work ex ante, it should generally be preferred to an ex-post alternative. An ex-post approach should only be utilized in situations where there is a clear advantage in not establishing the particular nature of employment relations in advance. Such an advantage could arise when the greater discretion afforded by an ex-post approach could help courts combat employers who behave strategically to escape strictly defined rules.[29] In these cases, giving courts discretion will make it much harder for employers to behave strategically when deciding whether to engage in fraudulent outsourcing relationships.

II. THE EX-POST APPROACH

The ex-post approach mainly involves distinguishing between fraudulent and authentic outsourcing transactions through a combination of two main sets of tests. The first test tries to determine the main reason for the employer's decision to engage in outsourcing. According to this type of test, the court would examine whether there is some independent economic rationale for outsourcing (flexibility, expertise, efficient allocation of

27. *See* Ronit Nadiv, unpublished Ph.D. dissertation, Tel-Aviv University (2004) (on file with author).

28. It should be noted that there is a new law—Employment by Temporary Help Firms (manpower contractors) Act of 1996. Since 1996, the temporary help industry has been regulated under specific regulation. This statute sets the standards for temporary help employment while applying regulations, formalizing the work of temporary help firms, and describing the basic rights of temporary help workers. This law does have some new ex-ante aspects attached to it, such as maximum length of nine months as well as some equal conditions clauses, however, its actual impact is limited since it deals only with specific employees and its more important sections were suspended by Ministry of Finance. Furthermore, the law has no relevancy regarding other forms of triangular relationship which are not based on temporary agencies.

29. *E.g.*, with regard to the maximum length of time allowed, firing the employee just before the period ends, or making sure that rules requiring equality would not apply due to some manipulation of the job description of the employee.

resources) or whether the main reason for the transaction is to avoid the employer's duties (which are based on either state laws or collective agreements). According to the second type of test, the court would attempt to determine the true nature of the triangular relationship and whether the formal employer or the user enterprises have stronger connections to the employee.

A. Identifying the Fraudulent Employer

To understand the fraudulent employment relationship, one must first understand what constitutes a legitimate employment relationship. Hence, the economic rationales that underlie outsourcing should be examined first. A firm's decision to contract out for business support services may be driven by several motivations. Some of the leading explanations include the volatility of output demand,[30] the availability of specialized skills possessed by the outside contractor, insufficient time to recruit or train new personnel, insufficient support or supervisory staff to manage work internally, lack of proximity of internal personnel to the needed work location, and the need for impartial or independent evaluations or judgments.[31] In contrast, in an illegitimate employment relationship, the outsourcing lacks any independent economic or business rationale. Rather, the main motivation is to avoid providing the worker with all of the protections owed to the user's internal employees. In such situations, the desire of the employer is to save wages and benefits that the primary employees enjoy due to either collective agreements or state laws, by hiring employees through an entity that doesn't have similar constraints with its employees. The Israeli Supreme Court[32] summarized the meaning of legitimate and illegitimate transactions as follows: "the purpose of a legitimate transaction is to achieve managerial flexibility, while the purpose of an artificial transaction is to escape the duties of the employer toward its employees."[33]

Courts in Israel have developed ex-post tests to distinguish among these various motivations for outsourcing. However, the conclusion that this paper wishes to draw from this review could be applied to the many

30. *See generally* Susan N. Houseman, *Why Employers Use Flexible Staffing Arrangements: Evidence from an Establishment Survey*, 55 INDUS. & LAB. REL. REV. 149 (2001). Based on a national organization survey in the United States, Houseman revealed that the most frequent reasons for outsourcing are as follows: volatility in demand for organizational products or services, a replacement for absent regular workers, and screening for regular employment.

31. *See* Katharine G. Abraham & Susan K. Taylor, *Firms' Use of Outside Contractors: Theory and Evidence*, 14 J. LAB. ECON. 394 (1996).

32. *See* RA"A 4381/03 *S.C Maagarey Enosh Ltd vs. Z.M Motagay Ophna* (case given 14/4/05, section 11) (on file with author).

33. *See*, Ruth Ben Israel, *supra* note 4.

countries that have based their protective techniques on a mostly ex-post approach.

B. Rationales for Striking Down Fraudulent Transactions in Israeli Case Law

In the beginning of the 1990s, Israeli judges introduced substantive tests to be considered when attempting to identify the "true" employer. These tests replaced the traditional test that tended to be much more formal.[34] This new substantive approach made it more difficult for the primary employer to evade responsibilities toward employees.

The basic argument used by courts in Israel was that if the user enterprise's main purpose was to escape responsibilities toward its employees through triangular relationships, the court should ignore the formal definition given by the parties, declare the relationship inauthentic, and treat the user enterprise as the true employer.[35]

The most influential decision in this line of reasoning was the National Labor Court case of the *Ruth Village*.[36] In that case, a subcontractor brought employees to work in agriculture in an Israeli residential community. On account of a lawsuit brought by one of the employees, the court asked the question, "who is the real employer?" According to the approach presented in *Ruth Village*, a screening test is conducted to allow the court to verify that no attempt was being made by the user enterprise to escape its responsibilities to the employee.[37] In this context, the court would also examine whether the purpose of the transaction contradicted the

34. The traditional approach of courts in Israel to the treatment of secondary employees was relatively formalistic. Courts tended to follow the language of the contract, without checking too much into the true nature of the transaction. If the language of the contract stated that the employer (contractor) is the formal employer rather than the user employer, courts needed exceptional circumstances to intervene and declare the user enterprise as the true employer. *See, e.g.*, Yoav Geva v. The State of Israel, D.B.A. MG/2-22 Yoav Geva v. The State of Israel, 16 P.D.A. 318 (1985). Mr. Geva was employed as a security guard in the Israeli Military Industries (IMI) through a private company, which paid his salary. Mr. Geva wished to be regarded as an employee of IMI since it supervised his work. The court ruled that this was neither a situation of joint employment nor of dual employment. The court based its judgment on the fact that there was no contract, which suggested that either joint or mutual employment was involved, but on the contrary there was a specific term in the contract between the private company and IMI that stated that Mr. Geva was not an employee of the latter.

35. *See* D.B.A NB/142-3 Hassan El Harinat v. Ruth Village, 24 (1) P.D.A 535 (1992); D.B.A ND/96-3 M.B. The Kibbuts' Construction Division v. Abed, 29(1) P.D.A 151(1995); L.A. 1189/00, Ilana Levinger v. The State of Israel (unpublished) (2000).

36. *See* Hassan El Harinat v. Ruth Village 24 (1) P.D.A 535 (1992).

37. In the original case of *Ruth Village* legal responsibilities included both rights based on labor laws and collective agreements. *See id.* The emphasis on both sources is important since, in many cases, part of the motivations for outsourcing is the attempt to escape the legal obligations employers have toward the primary employees. Hence, theoretically, courts that attempt to use the Ruth Village ruling must examine whether the secondary employees receive the rights primary employees achieve through collective agreements. In reality, very few cases truly expected secondary employees to receive all the conditions of the primary employees.

public order.[38] Following the screening stage, the courts moved, in the second stage, to an analysis of the functional realities in order to ascertain which enterprise's conduct more closely resembles that of a true employer. This task was achieved through a series of twelve "integration" tests to determine who maintains more responsibilities over the employee and hence should be legally viewed as the employer.[39] These tests resemble the tests used in the *Darden* case in the United States.[40]

Many cases in Israel have followed the same rationale, attempting to identify the true purpose of the transaction. In a representative case where medical doctors were not employed by the state but rather through some interim body,[41] the labor court very strictly argued that the outsourcing was a fictional transaction whose only purpose was to create two types of doctors, those who receive tenure and pension rights and those who do not.[42]

The next few paragraphs will demonstrate the problematic nature of the ex-post business purpose approach. The discussion will start with the inherent inconsistency in such an approach and will move to explore some of the factors that are responsible for this inconsistency. In the following sections, I will explore the sub-tests used by the courts to determine whether a transaction is authentic. I will then examine whether transforming these sub-tests to ex-ante bright line rules would positively influence the status of secondary employees.

38. Moreover, in order to avoid ambiguity, the court would require proof of contract between both the employer and the contractor and between the contractor and the employee.

39. The tests are as follows: What are the intentions of the parties?; Who can fire the employee?; Who hired the employee and agreed to his employment conditions?; Who set his salary and other employment conditions?; Who is legally obliged to pay his salary (the entity which actually pays is unimportant)?; Who gives him vacations?; Who reports to the tax authorities?; Who supervises the labor?; Who owns the means of production?; Is the work unique and temporary or is it the kind of work that the actual user needs regularly?; What is the length of time the employee has worked in the place?; Does the contractor have his own business of which the employee is an integral part?

40. *See generally* Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992). Although not dealing with triangular relationship, *Darden* offers thirteen tests that seem to resemble many of the *Ruth Village* tests: (1) the hiring party's right to control the manner and means by which the product is accomplished; (2) the skill required; (3) the source of the instrumentalities and tools; (4) the location of the work; (5) the duration of the relationship between the parties; (6) whether the hiring party has the right to assign additional projects to the hired party; (7) the extent of the hired party's discretion over when and how long to work; (8) the method of payment; (9) the hired party's role in hiring and paying assistants; (10) whether the work is part of the regular business of the hiring party; (11) whether the hiring party is in business; (12) the provision of employee benefits; and (13) the tax treatment of the hired party. *See* Stone, *supra* author note, at 23 for further discussion of American case law that discusses tests that examine who is the employer of temp-agencies employees under FLSA and OSHA.

41. *See* L.C. (Nazareth) 1014/04 Shiftan v. Ministry of Health (unpublished) (2005).

42. *See* L.A. 732/05 Municipality of Rehovot v. Israel Albachry (unpublished) (2006). The court thought that the employer was using the structure of TER to escape liability. The court paid attention to the fact that the agency was engaging only in paying salaries and hence could not be considered as the authentic employer.

C. Inconsistency

One of the fundamental problems in any ex-post approach is the inability to consistently identify the types of transactions that will be subject to court intervention.[43] Obviously, part of this inconsistency is related to the classic discussion of the limitation of a case-based vs. regulation-based approach.[44] However, it seems that this specific context pushes courts to reach exceptionally difficult decisions in attempting to identify the employer.

Any technique based on identifying the rationale behind the outsourcing transaction tends to be mostly ex-post.[45] Due to the complexity of the decision, it is difficult for the parties involved to predict the type of relationship that will be subject to court intervention. While it is hard for courts to decide whether a true business purpose existed, it is even harder for the secondary employer himself to anticipate a future court's decision. While this ambiguity carries some advantage with regard to curbing strategic behavior by employers, this complexity also makes it very cumbersome for secondary employees to know whether their own form of employment is legitimate.[46]

Courts have also demonstrated inconsistency in deciding whether hiring secondary employees as a means of reducing benefits constitutes a legitimate business purpose. In one case involving a municipality as an employer,[47] the municipality faced a financial crisis and the court argued that the relationship was legitimate since outsourcing would save much needed money. Hence, in the eyes of the courts, simply saving money on salaries was a legitimate motive. However, legitimizing such motivation seems to contradict the policy of courts against the creation of two classes of employees.

Much of the inequality in triangular employment relationships derives from the benefits that primary employees receive through collective agreements. It seems that courts have no consistent view on whether it is acceptable for employers to outsource work when a collective agreement is

43. *See* Stone, *supra* author note, at 258.

44. *See* Yuval Feldman & Alon Harel, *Social Norms, Self-Interest and Ambiguity: An Experimental Analysis of the Rule vs. Standard Dilemma*, REV. L. & ECON. (forthcoming 2009).

45. However, in Belgium one needs to examine ex ante the reason for outsourcing. Using temp employees is allowed only for activities that are temporary by nature (replacement, seasoned work, etc.) *See supra* note 10. A similar procedure exists in Germany, where permission is required prior to the employment, although in this country some ex-post examination is usually required. *See* Anke Freckmann, *Temporary Employment Business in Germany*, 15 INT'L COMPANY & COM. L. REV. 7 (2004).

46. *See* William L.R. Felstiner, Richard L. Abel & Austin Sarat, *The Emergence and Transformation of Disputes: Naming, Blaming, and Claiming . . .*, 15 LAW & SOC'Y REV. 631 (1980).

47. *See* A.S.K 1020/04 The Municipality of Be'er Sheva v. National Labor Union (2005).

in place.[48] The inconsistency in the ex-post business purpose approach is amplified due to the combination of three main characteristics of this approach. First, the fact that corporations outsource for many reasons, and it is hard to separate the legitimate reasons from the illegitimate ones. Furthermore, some rationales for outsourcing become legitimate over time, due to the fact that many corporations engage in it. Finally, courts don't always have the ability to reshape the transaction, even when they feel that its original design was fraudulent. In the following paragraphs these arguments are developed in more detail.

1. Multiple Reasons for Outsourcing

First, as explained, employers have various reasons for outsourcing,[49] rendering attempts to clarify the purpose of the business transaction very complicated and almost doomed by definition to fail. Moreover, as empirical data confirms, user enterprises may have multiple competing reasons for utilizing triangular employment relationships.[50] Furthermore, it is not clear what the status of a transaction should be when several alternative motivations (e.g., flexibility and saving labor costs) underlie a given transaction.[51] Since some of the reasons are legitimate and some are not, differentiating among them is an elusive task for the courts, increasing the bewilderment experienced by employees who try to predict the outcome in their specific case.

2. Prevalence and Legitimacy

Second, the view that a certain outsourcing motivation is legitimate could be created over time because many employers engage in these outsourcing practices.[52] When courts analyze the decision of employers to

48. *See* L.C. (Jerusalem) 2513/00 Zarifa Anat v. Ministry of Finances 364–65 (unpublished) (2005): "Employing through temp agencies for lengthy periods of time, prevent those employees from enjoying the protection of collective labor law." Interestingly enough, in that flagship case of *Ruth Village*, the court ruled that the user enterprise must guarantee the rights that primary employees receive under collective agreement, and not only the rights under the protective legislation. This emphasis by the court is very important, as rights from collective agreements are part of what lead to the inequality between both classes of employees. However, in most cases, courts did not require that secondary employees receive rights ensured by collective agreements, conceding de facto to the inequality between both classes of employees.

49. *See* the discussion above regarding the reasons for outsourcing; *see also* Abraham & Taylor, *supra* note 31, at 102.

50. *See* Houseman, *supra* note 30.

51. This is a situation that seems to be common according to the theories reviewed above.

52. *See* L.C. (Tel-Aviv) 5588/02 Hajbi v. State of Israel—Ministry of Education (unpublished) (2003). In that case, the courts used the argument that since the state buys services from a large number of companies, the practice should not be seen as an artificial one. Hence, the state defended its reliance on outsourcing based upon the fact that it has done so before. While the court does not use this factor as an isolated argument for seeing the transaction as legitimate, it is nonetheless troubling.

outsource and their behavior thereafter, the prevalence of the practice at that time may affect the perceived legitimacy of the transaction. For example, in a classic public sector case,[53] the court stated that if the relationship is stricken and the municipality is recognized as the employer, it would affect all of the municipalities in Israel, which might happen to engage in similar practices. Hence, since so many municipalities use outsourcing, it becomes a more legitimate type of business behavior. Similarly, the court says that due to the high prevalence of the practice of employees being leased from one company to another, there is no justification to view these employees as employees of the user enterprise.[54] However, a true understanding of the variety of reasons that underlie outsourcing would lead one to realize that this prevalence could be, among other factors, a product of the weak bargaining power of the employees in that sector and not necessarily a sign of business legitimacy. Naturally in an ex-ante regime, with clear rules, the likelihood that undesirable forms of employment would become justified, simply because of their prevalence, is limited. The dynamic effect of prevalence becomes even more destructive for secondary employees, since it increases the level of inconsistency of the courts' decisions in labeling certain relationships illegitimate.

3. Striking Down the Transaction Is an Inflexible Move

The third sanction is striking down the transaction and declaring the user enterprise the legal employer. One of the main observations from the case law discussed thus far is that the combination of vague standards and an all or nothing approach (i.e., relationship is declared as either fraudulent or legitimate) leads, by definition, to a hesitation by courts when attempting to identify the true rationale behind the relationship. While the focus on distinguishing and sanctioning fraudulent transactions has its advantages,[55] the utilization of this approach ex-post as the main technique for protecting secondary employees is problematic for many types of outsourcing that are not easily defined as fraudulent.[56] If courts were given a wider spectrum of remedies, such as responsibility for some of the benefits owed to secondary

53. *See* LA. (B.S.) 2515/01 Nina Toper v. Municipality of Tel-Sheva, 2004(2) TK-AV 3423 (2004).

54. *See* In the case of D.B.A MV/4-27 Malam Systems v. Histadrut, 18 P.D.A 57 (1986).

55. *See* discussion above at page 753.

56. Furthermore, it is important to note that even when we speak of an illegitimate business purpose, we are not usually dealing with a behavior of a few outlaws; rather, this phenomenon is widespread among many respected employers. In light of the prevalence of this phenomenon, when so many people from both private and the public sectors are involved, courts can be deterred from taking justifiable actions. Additionally, declaring a relationship "fraudulent" is very dramatic in the sense that it stigmatizes the employer as either lacking good faith or attempting to break the law. Under such circumstances, courts have to be very certain in their judgment.

employees, their hesitation to act would be reduced and the predictability of their decisions would increase.

The next step in exploring the advantages and disadvantages associated with the ex-post approach is related to the sub-tests used by courts to decide whether or not a certain employment relationship is authentic.

D. The Main Subsets of the Ex-Post Scrutiny of Outsourcing Transactions in Israel

1. Length of Employment as a Rationale for Ex-Post Intervention

The first subtest examines the length of time the secondary employee worked for the same user enterprise. The rationale for taking length of time into account is simple: If the employee is working for short periods, it is easier for the courts to view the situation as attempting to achieve flexibility that could not be achieved through the typical employment relationship.

A recent famous case effectively demonstrated the difficulty of the ex-post approach in protecting against extended lengths of employment.[57] In that case, the temp agencies were replaced several times over the years while the secondary employee continued to work for the same user enterprise for twenty years.[58] The court was very clear that such a practice manifestly violated the duty of good faith and ruled that the employee in question had always been an employee of the user enterprise (in this case the state). However, it is clear from the variation in the number of years considered by courts to be exploitive, how hard it is for the individual employee to predict the permissible length of time.[59] This uncertainty epitomizes the main advantages of the ex-post approach—it prevents

57. The *Levinger* case (*supra* note 35) concerned a secretary who worked for twenty years for the government without being regarded as an employee of the government. During this period, the temporary agencies came and went, but Ms. Levinger stayed in the same position only replacing the agency through which she was employed.

58. Ms. Levinger worked eleven years as an independent contractor and nine years as temporary employee.

59. *See, e.g.*, D.B.A. NZ/3-56 Tsvi Shaffir v. Nativ Bitsua Taasiati, 32 P.D.A. 241(1999). In that case, Mr. Shafir was employed through a temporary work agency in The Dead Sea Facility. He worked there for eight years, half the time as an employee of the TWA and half the time as an independent contractor. The court ruled that after eight years he should be seen as an employee of the "user" enterprise. There again, the employment conditions were not the motivating factor for legal intervention but rather the length of time this arrangement continued. However, a different conclusion was reached in a case with similar circumstances: L.A. 1427/04 The State of Israel v. Danny Roitman (unpublished) (2005). This case concerned eleven security guards who worked 2–8 years through a TWA. The court ruled that (said) the time periods were not long enough to justify intervention by the court to declare them as employees of the state in a temporary injunction. Due to the fact that the contractor provided minimum conditions to the employees, the court allowed the temporary agency to be considered as the actual employer. Thus, even a period of eight years was not seen as long enough to justify a declaration of the transaction as artificial.

employers from behaving strategically toward secondary employees.[60] However, as I discuss later on, the damage to employees might overshadow this advantage.

2. Inequality as a Rationale for Ex-Post Intervention

Another sub-test used occasionally by courts to justify intervention, is related to substantial inequalities between the secondary and the primary employees that can only be attributed to their formal status rather than to their output or responsibility.[61] For example, it is common for courts to say that they will not tolerate a situation where secondary employees are viewed as second-class employees.[62] At the same time, they will rarely receive all of the benefits enjoyed by primary employees. This de facto discrimination is created because the plethora of collective agreements will not cover secondary employees; hence, rights such as job security are missing. Furthermore, the court says that discrimination against secondary employees could be shown even without any substantive harm to the work conditions of the employee. Among the factors that the court discusses are aspects such as feelings of belonging, loyalty, and the like. Naturally, when such factors are included in the analysis of courts, it is difficult to see a situation in which secondary employees will not be viewed as discriminated against. At the same time, the fact that equality is so rarely reached demonstrates the gap between courts' rhetoric and action, in tolerating discrimination against secondary employees.

3. Lack of Respect for Employees' Minimal Conditions as an Ex-Post Rationale for Intervention

The third dimension used by courts in Israel as a proxy for fraudulent transactions is evident in their lack of tolerance of triangular business relationships in contexts where the secondary employee stands to receive less than what was promised by the subcontractor or mandated by the protective legislation.[63] This category is usually dealt with by other regimes through the joint employment/responsibility solutions. For

60. For example, employing secondary employees for shorter periods of time.

61. Justice Barak in *Levine*, states that: "If we don't examine the true nature of the relationship we shall create a situation where there are two classes of employees" (D.B.A 02-109 Daphna Levine vs. Social Security P.D.A 29(1) 326 (19/01/96).

62. In L.C. (Jerusalem) 2513/00 Zarifa Anat v. Ministry of Finances (unpublished) (2005), section 28, the court criticize a situation "where two classes of typewriters were created."

63. This "insurance" perspective was stated explicitly by deputy chief justice (*see Levine* case, *supra* note 62, at 329) who said that the policy of courts is to make sure that the rights of the employee would not be deprived simply because he does not have a stable employer, being transferred from hand to hand.

example, in the influential case of *The Construction Division*,[64] the court extended its protection to situations in which the contractor had gone out of business or skipped the country.[65]

As I will demonstrate in the following paragraphs, all three subtests are similar to the major failures that are subject to ex-ante restrictions in other legal regimes.[66] The comparison of the treatment of these failures will be used to examine the theoretical and practical differences between the ex-ante and ex-post approaches.

III. EX-POST OR EX-ANTE?

Most countries seem to oppose exploitative triangular relationships designed purely to bypass employee's rights, substantial inequality between regular employees and temporary ones, situations where the secondary employee does not get what he was promised, and lengthy periods of temporary employment.[67] While countries differed in the techniques they have used to protect secondary employees, it is possible to show that all the different techniques could be analyzed according to the level of the courts' discretion they provide. The following sections will review the major failures associated with an ex-post intervention.

A. Length-of-Time Test

1. Disadvantage of Using the Length-of-Time Test Ex-Post

The most vivid example of the limitation of the ex-post approach is the length-of-time test. A review of all Israeli cases that have used the length of time as an indicator for the illegitimacy of the transaction will reveal great inconsistencies in the number of years the courts considered legitimate. Each case had a different length of temporary employment considered to be illegitimate, starting at only few months and ending in

64. *See supra* note 35.

65. The circumstances of that case were as follows: The construction division of the kibbutzim in Israel had employed workers through a subcontractor. The subcontractor encountered financial difficulties and left the country without paying the salaries of the employees. The majority opinion was that of zero tolerance with regard to situations in which employees were not being compensated. The court explored the concept of the statutory employer and the feasibility of applying this concept in Israel. While the court did not rule as to the existence of such a doctrine in Israel, it did hold the construction division responsible for the debts of the subcontractor to its employees. An ex-ante solution that exists in many of the states in the US for this problem is the Mechanic's lien. For example, in CAL. CIV. CODE § 3123 (West 2008), an unpaid contractor can record a mechanic's lien on the property upon which he worked.

66. For example in the EU Directive 99/70, Annex [1999] OS L 175 143. Directive 97/81, Annex cl 4.1[1998] OS L.149. *See* discussion of Belgium and France, *supra* note 11 and Germany, *supra* note 46.

67. *See* Tamajo & Perulli, *supra* author note.

twenty years.[68] In one case,[69] the court stated that while it recognizes the problems associated with firing employees after ten years, since the employees were aware of their "temporary" status they have no right to argue against their dismissal. However, in other cases,[70] the courts state that even though the employees were working for the municipality for short periods of time, this fact should not prevent the court from striking down the transaction and declaring the user enterprise the true employer. The lack of consensus on the permitted maximal tenure of secondary employment renders this test unhelpful from the perspective of secondary employees. This inconsistency leads to a situation in which the employee cannot know ex-ante what his status will be. This fact adds uncertainty to the employment relationship, since the employee can only discern problems in his employment status once time has passed. As long as this length of time is measured in years, it is not clear whether this sub-test threatens the employer who wishes to "discriminate" against his secondary employees for shorter periods of time.

2. Advantage of Using the Length of Time Test in an Ex-Post manner

In some countries, the length of time is mandated ex-ante, not ex-post. For example, in France the maximum is eighteen months.[71] This was previously the case in Germany, where the period of work at a user enterprise was limited to twenty-four months.[72] In Israel as well, legislation was introduced in an effort to create ex-ante time limits on legitimate triangular relationships.[73] While inconsistency is problematic, as explained in the previous section, when one considers the concept of acoustic

68. Twenty years in the *Levinger* case (*see supra* note 36), 2 to 16 years in *Zarifa* (see *supra* note 62), 4 to 9 years in L.A. 326/03 State of Israel-Ministry of Health v. Yelena Chepkov (unpublished) (2006), 14 years in L.C. (Be'er Sheva) 2449/00 Ben Moyal v. Dead Sea Industries (unpublished) (2005), 10 years in L.A. 198/05 Israel Electric Corp. v. Alexander Volovitz (unpublished) (2005), 2 to 10 years in L.C. (Jerusalem) 2909/04 Meirav Cohen and others v. State of Israel-Ministry of Transport (unpublished) (2005), 3 to 9 years in the *Hajbi* case (see *supra* note 52), 8 years in *Shaffir* (see *supra* note 59), 2 to 8 years in *Roitman* (see *supra* note 59), 7 years in L.C. (Tel-Aviv) 911583/99 Hani Avni-Cohen v. State of Israel-Court's management (unpublished) (2001), 6 years in L.C.(Tel-Aviv) 2732/01 Yonna Alush v. General Health Services, Tigbur Ltd. (unpublished) (2004), 5 years in D.B.A 3-25 Moshe Kipnis vs. Ezra (85/09/09), a few months to 4 years in *Municipality of Rehovot* (see *supra* note 42), 3.5 years in *Shiftan* (see *supra* note 41), 3 years in D.B.A/ N.L.C 57 3/54 Mishel Lankri v. A.N.S Possessions and Investments Company Ltd., P.D.A 36, 361, 634 (2000), a year and a half in *Levine* (see *supra* note 61) and in L.C.(Tel Aviv) 7844/01 Kachlon Izhak v. Tigbur Professional Temporary Manpower Resources Ltd. (unpublished) (2005).

69. *See Volovitz supra* note 68 (although in that case the decision was in an interim stage).

70. *E.g.*, *Municipality of Rehovot*, *supra* note 42.

71. *See* Smith-Vidal *supra* note 10.

72. *See* Freckmann *supra* note 45, at 8.

73. The Employment of Employees by Manpower Contractors Law (1996) (Isr.) was created to add some ex-ante requirements of length of time as well as equality. However, for various political reasons, major parts of that law, including these sections, were suspended by the government.

separation,[74] usually used in the criminal law context, this inconsistency carries a positive value. By analogy, it may be beneficial that employers not be able to predict the permissible length of time that they can employ secondary employees without being forced to hire them. When the length of time is announced ex-ante, employers can more easily behave strategically, and employees can be forced to change companies without receiving serious consideration for a permanent job. Hence, while no specific employer could be held accountable for exploiting the rights of these secondary employees,[75] their rights will be jeopardized compared to the market possibilities of primary employees.[76] Furthermore, the ex-ante approach that puts a rigid constraint on the permissible length of time might limit flexible employment arrangements, even when they are legitimate. Establishing durational time limits in a "one size fits all" approach might stifle the secondary employee's human capital development, which varies in different sectors and work settings. Consequently, it might restrict the availability of secondary employees in situations in which both business needs and public interests might be best served by permitting such employment arrangements.

B. Equality between Primary and Secondary Employees

Equality is an approach with growing popularity around the world. EU directives rule that there must be equal conditions for all employees who perform the same work, irrespective of how the employment relationship is defined.[77] This rule seems to be ex-ante. However, according to Zappala,[78] since some of the exceptions are vague, the courts have much discretion. Furthermore, the law examines whether the purpose of the transaction was legitimate. According to the European directives, a precondition is determining whether there are legitimate reasons for the discrepancy between secondary and primary employees.

The European directives maintain equality through the obligation to inform temporary employees of new available positions,[79] and through a

74. *See* Meir Dan Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984).

75. As he would fire them, prior to the end of the pre-defined permissible length of time.

76. This would more likely harm those employees whose human capital could be easily substituted due to a lack of firm specific knowledge.

77. Directive 99/70, Annex [1999] OJ L 175 143; Directive 97/81, Annex cl 4.1 [1998] OJ L 149. For reference to: COM/2002/0149; COD/2002/0072. *See* ROGER BLANPAIN, EUROPEAN LABOUR LAW (10th ed. 2006).

78. *See* Loredana Zappala, *The Temporary Agency Workers' Directive: An Impossible Political Agreement?*, 32 INDUS. L.J. 310 (2003).

79. *Id*. § 6.

duty of representation for temporary employees.[80] Similarly, Germany has an ex-ante[81] assurance of equality. The attempt to ensure equality between primary and secondary employees, either ex-post or ex-ante is challenging for a number of reasons.

First, there is a very strong interrelationship between tenure and equality. Usually, primary employees have longer tenure than secondary employees working in the same firm. Therefore, we might end up comparing apples and oranges, and have the state compel employers to eliminate justified differences in employee conditions. If length of time is one of the major factors that lead courts to examine whether discrimination exists between secondary and primary employees, employers might focus not on improving conditions but rather on replacing their secondary employees more often than they would otherwise. Thus, in practice, protecting equality ex-ante might lead to a situation whereby employers purposefully limit the tenure of secondary employees before inequality can be detected.

Second, in many cases there is simply no reference group for the court to compare and examine whether the secondary employee is indeed being discriminated against.[82] This problem is not limited only to small organizations; it is also the case with regard to bigger organizations where primary employees enjoy distinctive characteristics, which could only be gained through lengthy periods of employment. Furthermore, in many cases, the worker performing outsource work may not have sufficient contacts with the primary workforce to become aware of inequalities in treatment.

Third, some scholars argue that there are conceptual problems in the use of equality in cases of more than one employer. For example, Collins[83] discusses the problematic role of finding the right group for comparison between different types of employees.[84] According to Collins, there are some structural problems in achieving equality between primary and secondary employees.[85] The expectation that an employer will not

80. *Id*. §§ 7–8.

81. *See* Freckmann, *supra* note 45.

82. In that regard, the example of *Zarifa* (*supra* note 62) is important. In that case, the employer was trying to prevent an argument of equality by putting the employees in separate rooms, arguing that, in fact they were not doing the same work.

83. *See* Hugh Collins, *Multi-segmented Workforces, Comparative Fairness, and the Capital Boundary Obstacle*, *in* BOUNDARIES AND FRONTIERS OF LABOUR LAW: GOALS AND MEANS IN THE REGULATION OF WORK 317 (Guy Davidov & Brian Langille eds., 2006).

84. For a discussion of the European Directives that deal with equality between primary and secondary employees see *id*.

85. Furthermore, the ECJ itself has rules that only when there is a single source it is possible to speak of a comparison between different employees. C-320/00 Lawrence v. Regent Office Care Ltd. [2002] ECR I-7325, [2003] ICR 1092 (ECJ).

discriminate against different employees is limited only to employees of the same employer and not to employees of different employers. Furthermore, even within one employer, there are sometimes two-tier wage and benefit structures for their own employees that cannot be eliminated purely on the basis of inequality, as long as the employer is not using one of the "forbidden" criteria.[86]

C. The Problem with an Ex-Post Approach to Equality

Despite the above-mentioned difficulties associated with equality as an intervention technique, regimes that focus on an ex-post approach still consider the creation of two distinctive subsectors a main factor in intervention decisions.[87] A closer look at the case law reveals the danger of mandating equality through an ex-post approach, for a number of reasons.

First, for the most part, courts only start examining the issue of equality when secondary employees are employed for relatively longer periods of time. This connection between equality and length of time is problematic for the individual employee, who does not know whether he is being discriminated against until long periods have passed.[88]

Second, there has to be significant difference between the two classes of employees for the secondary employee to recognize the gap and see it as exploitation. The gap must also be substantial enough to win a suit in a regime that focuses on identifying fraudulent transactions. Without clear guidance as to the exact definition of inequality, it would be difficult for a secondary employee to know if he is the victim of discrimination, since there is such a strong relationship between the role of the employee and the salary and benefits he receives. This would be particularly problematic when it comes to small organizations, where no clear baseline for a comparison exists. Since employees tend to be even more risk averse, (filing suit poses a great risk for them), they will only file suit when they are certain of their success.

In contrast, if equality is applied in an ex-ante approach, it could lead to a situation whereby an employer will know ex-ante that he cannot hire a

86. For example, gender, race.

87. *See Shiftan*, *supra* note 41. *See also* L.A 1400/02 Uzi Hatan vs. the Ministry of Internal Security. The case pertained to a claim by civilian police officers for discrimination in their employment conditions in comparison to regular police officers. The Israeli Police had temporary positions for civilian police officers who were in charge of the security of border towns in Israel. In reality those temporary positions were filled by the same people for long periods. The court was very specific in arguing that the situation could be tolerated only because there was a gap in the requirements between civilian and regular police officers. It was clear for the court that if not for that difference in requirements, such inequality could not be tolerated.

88. It is too late for any individual employee, making it very difficult for that employee to plan and know his status, especially when the recognition of inequality arises after a long period of time.

secondary employee without respecting his rights as stated in the collective agreement. Thus, ex-ante equality can achieve much more than just creating equal conditions; it can also deter employers from outsourcing for the wrong reasons. If the ex-ante equality requirement is not linked to tenure, it will be much harder for the employer to behave strategically in his attempts to exploit secondary employees.

The forgoing critique does not mean to suggest that there is no logic in leaving the courts the discretion to decide whether it is beneficial to mandate equality in a given situation. However, by maintaining an ex-ante presumption in favor of the employee, there are greater chances that exploitation will not occur in the first place.

D. Provision of Minimal and Promised Conditions

The last type of ex-post technique targets cases in which, due to the structure of the relationship, the employee receives less than what is promised or what is required by protective legislation. According to this approach, the state should not allow a situation whereby the rights of the secondary employees are deprived. In Israel, one of the main achievements of the legal system has been to almost completely eliminate situations where user enterprises use the triangular relationship as a way of escaping basic responsibility toward employees.[89] In contrast to other situations in Israel, in which the ex-post approach led to inconsistency and unpredictability, in this instance courts were very consistent in striking down transactions where the employer violated its commitments toward the secondary employees.[90]

However, while the ex-post approach functions well in this context, there is little benefit in delaying the decision to the end of the employment relationship. Unlike issues of equality or length of time, when it comes to provision of basic conditions, no strategic behavior by an employer is ever tolerated by the courts, so there is no need for judicial discretion. Furthermore, the cases where the triangular relationship status is responsible for severe exploitation (such as not providing legally mandated benefits) usually involve the weakest employees. Since in these cases there is no real need for deliberation into the circumstances of the relationship, the delay related to judicial proceeding can be prohibitively damaging to these employees.

To prevent situations as the ones described above, many countries apply the joint employer test in extreme cases of employers ignoring

89. *See, e.g.*, *The Kibbutz Construction Division*, *supra* note 35.
90. For that purpose, it seems that a several and joint approach is the best approach.

secondary employee rights.[91] It is not usually employed in less severe cases such as artificial relationships, or when there is a disparity between the condition of primary and secondary employees. Thus, this technique is mostly limited to preventing "catastrophic" outcomes of triangular relationships. However, it has the indirect effect of legitimizing more moderate exploitations triggered by triangular relationships.

IV. SUMMARY

Thus far, the article discussed the strengths and weaknesses of unpredictability in protecting the rights of secondary employees. We emphasized its importance in preventing strategic behavior by the employer, but also illustrated how it can prevent secondary workers from understanding their legal status and, hence, rights. The analysis was restricted to the three main techniques that are prevalent around the world, demonstrating how each of them can be dealt with either through an ex-ante or ex-post approach. For each technique, we examined whether the benefits of inconsistency justify the costs.

The advantage of implementing an ex-ante approach, focusing on equality, to protect secondary employee rights, was demonstrated by showing how certain discriminatory policies would not be risked by employers if they anticipated that strict equality would be enforced.[92] Yet, despite the advantages of an ex-ante approach to equality, determining which aspects of equality should be ensured is still a daunting task. Nevertheless, if such an approach could be used even in a limited fashion—such as to guarantee equality of rights afforded by collective agreements—there would be much less need for ex-post intervention.

In contrast, regarding the technique of limiting the maximum length of employment in a non-fraudulent triangular relationship, creating ex-ante rules could easily lead to strategic behavior by the employer. At the same time, ex-post application of the maximum length of time technique is also problematic, since the employee can only know what his status is after his tenure ends.

However, there is no reason why the "provision of basic conditions" test should not be applied solely ex-ante. Automatic joint responsibility would reduce the need to prove that the user enterprise was the real employer, and the claim of secondary employees to receive what was

91. Recently, two courts in Israel suggested that the joint employer test should be considered in Israel as well. *See* L.C.04/30 Smueluv v. Punesh, (10/12/06) based on L.A 273/03 Scwab v. State of Israel (2.11.06).

92. Such an approach effectively limits the most common incentive to outsource: reduction of employment costs.

promised to them is relatively straightforward. When employers know that there is a real chance that they could be held liable for mistreatment of secondary employees, there will be less room for strategic behavior. Hence, in that regard, the advantages of the ex-ante approach seem to eclipse that of the ex-post one.

While there are ex-ante tests in some countries to determine the authenticity of a relationship,[93] it seems that for the most part reality is too complex to rely solely on an ex-ante approach. The large number of nuances would render the product of such efforts artificial or misleading. The amorphousness of the circumstances that could form an artificial relationship would invite strategic behavior by employers. Such strategic behavior can be blocked only by an ex-post approach that gives courts broad discretion to review the nature of the transaction. On the other hand, an ex-post approach seeking to deal with inauthentic relationships has many drawbacks, as discussed in great length. Ensuring that secondary employees and aspects such as equality not fall between the cracks is also important in legal regimes that supposedly care only for the authenticity of the outsourcing transaction. The analysis of the pros and cons of using the techniques discussed as part of an either ex-post or ex-ante approach, is the basis for the policy implications addressed in the following section.

V. TOWARD AN INTEGRATIVE MODEL

The argument developed in this paper is that in order to effectively combat the inadequacy of triangular relationships, an approach combining ex-ante and ex-post techniques is preferred.[94]

As demonstrated in the previous sections, the main method in the context of employment should be based on ex-ante rules. Such rules are likely to reduce litigation costs in employment contexts, where filing a suit is relatively complex. The failures associated with an ex-post approach were demonstrated through case law. Given the simplicity of the ex-ante approach from the perspective of secondary employees, deviation from this approach should be limited to instances in which there are strong policy considerations in favor of court discretion. Even in these instances an integrated approach is to be preferred. Such an approach would curb some of the failures of pure ex-post intervention as will be demonstrated in the following paragraphs.

93. *See, e.g.*, Smith-Vidal *supra* note 10, (for an example in France) .

94. For a discussion of the recent legislature changes suggested in Israel and their limitations, see *supra* note 29. In the case of U.S. law, some similarity to this approach could be seen with regard to the OSHA as well as FLSA. *See* Davidov, *supra* author note for his suggestions on expanding the reach of employment Protection Statutes to secondary employees.

A technique that focuses on striking down fraudulent transactions ex-post, for lack of authenticity, should be augmented by other techniques discussed in this paper. While it is imperative for courts to have the ability to strike relationships and determine the identity of the legal employer, such a technique cannot work in isolation. Giving courts a variety of intervention techniques to choose from would increase the situations in which they would intervene, since they would not have to make an all-or-nothing selection. Striking down the relationship and making the user enterprise the sole employer, is far less flexible than, for example, an integrated approach under which the court could mandate equality with respect to benefits, or shared responsibility to provide minimum wage or overtime payments.

Adding ex-ante regulation mandating equality would lessen the burden associated with deciding ex-post on the authenticity of a transaction. In this respect, it is imperative that we differentiate between equality as an objective, and equality as a deterrent to illegitimate business practices. Requiring equality ex-ante would block many fraudulent transactions and would therefore lessen the percentage of relationships that need to be examined ex-post. It is neither reasonable nor beneficial to require employers to give secondary employees the exact same conditions as primary employees. However, the existence of a disparity between these two kinds of employees should provoke an inquiry by courts that would require the employer to justify the inequality.[95] In a situation where primary employees only enjoy greater benefits because of their longer tenure or other justified reasons, the courts cannot force the employer to provide temporary secondary workers with the hard-earned conditions of the primary employees. However, if the employer is unable to show a legitimate reason for the difference between the employees, then the courts should be especially suspicious about the business purpose of that relationship.[96] Hence, mandating equal treatment will enable courts to distinguish more easily between legitimate and illegitimate relationships. Using equality among employees as an initial screening mechanism will preclude those whose "efficiency" is driven purely by the greater ability employers have to discriminate against secondary employees. Instead of delving into the elusive task of identifying the business purpose of the triangular relationship, requiring equality among employees as the baseline

95. Similar to the first stage, the employer needs to pass according to the *Ruth Village* ruling, see *supra* note 35.

96. To complete this argument, there is a need to decide whether the business purpose of saving the costs of collective bargaining is a permissible move. At this stage we do not wish to open this very interesting question, but rather present in general terms the importance of incorporating equality into the business purpose test.

will create a natural sorting of artificial and genuine business transactions. According to the proposed approach, a secondary employee will have a claim against the user enterprise whenever he can demonstrate that his work conditions are worse than those of primary employees. This approach should prevent situations in which the employer attempts to escape its duties toward its secondary employees.

Another benefit of creating ex-ante requirements of equality is that the employee will more easily realize that his rights are being infringed upon. When the criterion of exploitation is established only by identifying the "true business purpose" of the outsourcing relationship, the employee's ability to identify exploitation is naturally limited. The cost of information is sometimes prohibitive for the individual employee. As shown, even courts are undecided about what an authentic relationship means. Therefore, lawmakers must reduce the costs of information to the employee, and equality seems to be a perfect cost reduction proxy.

The use of inequality as a screening test for exploitation will also shift the burden of proof. The user enterprise must either justify inequality of benefits, or be considered the employer of the secondary employee.[97] This will lead to a dramatic decrease in the number of relationships whose cost reduction emanates solely from cutting benefits employees would receive had they worked as primary employees. When the non-justified gaps in conditions are reduced, it will be easier to determine which employers have other economic rationales for engaging in outsourcing.

Recognizing the advantages of an ex-ante requirement of equality, there are some problems that should be mentioned. First, some rights are based on tenure. Second, in order for courts to recognize the existence of inequality, primary and secondary employees must have similar responsibilities. However, it seems that using inequality to shift the burden of proof to the employer, rather than as a conclusive presumption, might mitigate this problem. Employers could always argue against this presumption, but the burden of proof would be on them to demonstrate that inequality is justified. A combination with ex-post scrutiny by courts would ensure that employers would not behave strategically on the one hand, and could explain justified inequalities on the other. Since it is easy for employers to create disparity in responsibilities or frequently replace temporary employees, giving courts discretion is very important to curb such strategic attempts to prevent detection of inequalities. It is equally

97. For a discussion about one of the main problems in ensuring equality between secondary and primary employees, see Collins, *supra* note 83. Collins discusses the problematic role of findings the right group for comparison between different types of employees.

important to allow employers who behave in good faith to justify their behavior without being tagged as violating employee rights.

A final policy implication that seems to arise from the above discussion is the need to increase the available spectrum of remedies available to courts. The requirement in many countries that a fraudulent employer be viewed as the employer to compel responsibility for the secondary employees seems to be too rigid. A more flexible solution would allow the court greater leverage in the remedies it can offer, such as partial payments, responsibility for some of the benefits received by the primary employees, as well as for the implementation of a certain set of employment laws. Since declaring the user enterprise the true employer threatens the very existence of this form of employment relationship, courts might not want to engage in such a practice unless they really have no choice but to intervene. However, if courts could improve a specific work condition or force the user entity to be responsible for certain (but not all of) employment benefits, knowing that the decision to intervene is not necessarily followed by a ruling voiding the entire relationship, they will have much greater leverage in deciding whether or not to intervene. Giving courts greater discretion could offer a more sensible approach to some of the gray areas where simple implementation of the law is not possible. At the same time, it is important to give courts the discretion to strike down relationships even when all ex-ante bright-line rules are fulfilled. This extreme remedy could be reserved for use in only the most extreme cases, for which moderate solutions might not be enough. To summarize, placing all intervention techniques on the table will improve the possibility that each of them will be used in the right manner.