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Employment Discrimination and Its Evolving Impact on an Employer's Relationship with Independent Contractors

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The Great Society Employment Laws Protect "Employees"

The Great Society civil rights programs of the 1960s ushered in a whole panoply of anti-discrimination laws affecting activities such as employment, education, transportation, and public accommodations. Title VII of the 1964 Civil Rights Act ("Title VII") prohibits discrimination against employees based upon race, gender, religion, nationality, and other categories. The Age Discrimination in Employment Act ("ADEA") and the Americans with Disabilities Act ("ADA") prohibit discrimination against employees based upon age and disability. Similarly, a number of other federal statutes, virtually all of which were passed after 1964, seek to "level the playing field" in the workplace.

Title VII, in its very provisions, as well as the other employment discrimination statutes, apply only to "employees." The "workplace," as it existed in 1964, consisted primarily of employees as we commonly understand the term — people who work five days a week, eight hours a day, receive W-2 tax forms, and report to an employer who controls the terms and conditions of their employment. The workplace of 50 years ago has, of course, changed dramatically. More and more people in the workplace are classified as "independent contractors," and not as "employees," and more employers are phasing out employees in favor of independent contractors. Since the anti-discrimination laws cover employees only, the lack of coverage for independent contractors has attracted the attention of workers' rights advocates, both in and out of Congress.

The Changing Workplace

The reason for the rise in the number of independent contractors is simple: they are cheaper, because it is not customary for employers to provide independent contractors with benefits such as paid vacation days, pension plans, and employer-sponsored health insurance. Moreover, an employer need not withhold federal and state income taxes and Social Security tax on compensation for independent contractors, and is not required to pay federal and state unemployment insurance and the employer share of Social Security taxes.

Similarly, the relationship between employer and independent contractor is more flexible; independent contractors are more easily terminated (especially in states that have abandoned the "employment at will" doctrine) because they are not covered by the civil rights laws cited above.[1]

But employers have learned the hard way that merely by calling someone an independent contractor does not make it so. Employers must be certain that their workers are true independent contractors and not merely employees with an

independent contractor label. Failing to do so, as, for example, Microsoft learned, may lead to lawsuits by employees who have been mislabeled as independent contractors seeking to receive employment benefits traditionally reserved for true employees, as well as suits by governmental agencies such as departments of labor.[2]

We are likely to see more and more worker and governmental activism in this area. Recently, it was reported that attorneys general from New York, New Jersey, and Montana intend to sue FedEx Ground Package System if it "blatantly misclassifies" its workers as independent contractors rather than as employees, as New York Attorney General Andrew Cuomo declared.

Two Commonly Used Tests to Distinguish Employees from Independent Contractors

Because so much is at stake in this classification of workers, it is imperative that employers familiarize themselves with the various tests utilized by courts to distinguish employees from independent contractors. These tests review a variety of factors, ranging from the degree of employer control over the worker to the length of the employment relationship.

For example, in the 1989 seminal case of *Community for Creative Non-Violence v. Reid*, the Supreme Court established a 13-point test to determine whether a hired party is an "employee." This test looks at the following factors: the hiring party's right to control the manner and means by which the product is made or the service rendered; the skills required for the job; the source of the instrumentalities and tools; the physical location of the parties; the duration of the relationship between the parties; whether the hiring party has a right to assign additional projects; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in the business; the provision of employee benefits; and the tax treatment of the hired party.

In contrast to the Supreme Court's test, the IRS has its own test that employs various factors to determine whether the employer "has the right to direct and control the worker." The more control over the worker, the more likely that the worker is an employee rather than an independent contractor.

For example, evidence of such control exists where a worker must comply with instructions about when, where, and how he is to work; there is training of a worker by teaming him with an experienced employee (indicating that the employer wants services done in a particular manner or method); the worker's services must be rendered personally; the business hires, supervises, and pays assistants for the worker; there is a continuing relationship; the employer has the right to fire the worker; there is a requirement that the work is to be performed on the premises, the service is to be performed in a specific order or sequence, and/or there must be regular or written reports; and where the employer supplies tools, material, and equipment.

On the other hand, when an employer pays a worker by the job or on a commission basis, it suggests lack of control and is therefore indicative of an independent

contractor relationship. Similarly, if a worker invests in facilities that are not maintained by employees (i.e., renting his own office), realizes a profit or loss, performs more than minimal services for a number of unrelated businesses at the same time, and makes his services available to the general public on a regular basis, this suggests that he is an independent contractor.

The Benefits of Utilizing Independent Contractors

It would appear that the use of independent contractors is a cost-efficient tool for employers. This is made more so by simply reviewing the statistics relating to the number of claims and complaints of employment discrimination that have been made by employees in recent years. Administrative agencies such as the EEOC are inundated by such claims, which are cheap and simple since no legal counsel is required or needed. The courts are now jammed with such cases, often brought pro se. In fact, for the last several years, employment discrimination lawsuits are one of the most commonly filed in the federal courts. Further, behind litigation, employment and labor costs were the largest expense for corporate law department budgets in 2009, and a recently published study predicts that in 2010, corporate law department budgets for such cases will increase by an additional 12%, largely due to the economy-driven layoffs and terminations and the concomitant increase in "wrongful termination" suits. These claims and cases are extraordinarily expensive, time-consuming and distracting.

However, lest an employer, after reviewing the pros and cons of independent contractors and the legal tests noted above, decide to run out and convert the entire workforce to independent contractors and thereby breathe a sigh of relief to be rid of possible liability for discrimination claims (along with excess costs), beware! With a (relatively) new President and Congress, increased activism by civil rights organizations and others, and a rising unemployment rate, we may see the dawn of new civil rights laws, or the expansion of old civil rights laws. And independent contractors may be on the radar screen to be covered.

Why Civil Rights Laws May End Up Covering Independent Contractors

It might seem anomalous in 2009 that independent contractors are not included within the protections of Title VII. After all, as the Microsoft case shows, simply changing a label does not change the fact that an employee and an independent contractor are part of the same workforce and may even do the same job. There is also no evidence that a change of label makes a worker who is an independent contractor any less likely to be discriminated against — and a level playing field in the workplace was the very reason that the Great Society laws were enacted.

But the economy and the workforce of 50 years ago were very different than the present ones, and Congress then could not had envisioned the rise of independent contractors as a labor force. Perhaps the authors of Title VII would have included independent contractors within its protections if it had. And given the apparent anomaly, many think it is about time that it did.

There has been movement during the last few years to provide anti-discrimination protection to independent contractors. Some legal commentators have argued

recently that Congress should expand Title VII (and the other employment discrimination laws) to give independent contractors full Title VII protection, reflecting the change in workforce composition. While there are a number of statutory reforms currently being considered by Congress, the protection of independent contractors within the current employment discrimination statute does not seem to be on the agenda — yet. However, other means to achieve this end are being contemplated.

The Impact of Federal Statute, Section 1981

Perhaps more significantly and ominous for employers is the re-emergence and revitalization of a mid-19th century, Reconstruction-era anti-discrimination law known as Section 1981 of the Civil Rights Act of 1866 ("Section 1981"). This statute was passed right after the Civil War to protect the rights of freed slaves who had become the subject of very restrictive "black codes" in southern states passed in reaction to the enactment of the Thirteenth Amendment. Section 1981 prohibits racial discrimination (and only racial discrimination) in the making and enforcement of contracts. In essence, Section 1981 prohibits discrimination regarding the right to contract based upon race and color.

Specifically, the statute provides that "all persons … shall have the same right … to make and enforce contracts … as is enjoyed by white citizens." Until the passage of Title VII, this statute was the only federal anti-discrimination statute regulating private acts and behavior.

Section 1981 was eventually amended and construed to include within its protection other groups based upon race and color such as those of the Jewish faith, and its definition of "make and enforce contracts" was significantly expanded to include "the making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship."

Although Section 1981 does not, by its language, expressly apply to employment contracts, in 1975 the Supreme Court held that Section 1981 applies to employment contracts, and this has been interpreted as applying to implicit, employment at-will contracts. Accordingly, some academics and lawyers have argued that Section 1981 might provide the appropriate vehicle to expand discrimination protections to cover independent contractors, if not as presently written, then with future amendments. A number of lawsuits have been brought recently in which Section 1981 is the proposed touchstone to base such rights. In fact, as recently as early October, a federal court in Brooklyn re-stated the proposition that a plaintiff may have a viable claim based upon race under Section 1981 due to a denial of employment.[3]

In the recent case of *Brown v. J. Kaz, Inc.*, an African-American female who was not retained as an independent sales representative filed an employment discrimination action based upon her race, under both Title VII and Section 1981. The federal appeals Court in Philadelphia first determined that Brown was not an "employee" under the definition set forth in Title VII, but an independent contractor, and therefore dismissed the Title VII claim (as well as the state law claims). However, with respect to the Section 1981 claim, the court stated that "we have not previously decided the issue" of whether an independent contractor (such as Brown) could sue.

Noting that three other appeals courts had ruled in the affirmative, the court held that Section 1981 is not limited to employment contracts but also applies to contracts with independent contractors. The court stated that it "agrees with the decisions that hold that an independent contractor may bring a cause of action under section 1981 for discrimination within the scope of the independent contractor relationship."

This is a very significant case for employers because this is an influential court and its decision follows three decisions of court of similar stature. Unless overturned or reversed, this decision means that an employer is no longer immune from race discrimination suits simply by virtue of the status of the claimant being one of independent contractor rather than employee.

While Section 1981 relates only to race discrimination, there is no reason to think that Congress could not amend it to make its reach functionally equivalent to that of Title VII. This would be much simpler than amending the numerous applicable sections of Title VII and the other ant-discrimination laws. For example, it could be amended to include within its protection persons who are prevented from contracting or enforcing contracts due to their age, gender, religion, disability, etc.

As an interesting postscript to this article on discrimination law and independent contractors, the U.S. Court of Appeals in New York, in *Halpert v. Manhattan Apartments, Inc.*, extended the liability of an employer that did not do its own hiring but outsourced this activity to an independent contractor whose alleged discrimination was imputed to the employer. While this case did not involve an employer's liability to an independent contractor, as did *Kaz*, but an employer's liability to a prospective employee by virtue of the acts of the independent contractor, nonetheless it illustrates the fact that in every aspect of the employment continuum, courts are recognizing the existence of independent contractors and carving out new law to account for them.

Although in *Halpert* the court did not go into the merits of the case, the court based its holding upon principles of agency law and held that the crucial issue was whether the independent contractor was acting as the employer's "agent" or "apparent agent" when making hiring decisions. In other words, if the independent contractor's actions are, in fact, or appear to be the acts of the employer, then the employer will most likely be held responsible for the independent contractor's actions.

While this case turned on agency law and not employment discrimination law or Section 1981, nonetheless it puts employers on notice that what the employer cannot do, its agent cannot do. An employer cannot discriminate in the terms and conditions of employment, and, similarly, its agent cannot discriminate, even if the agent is not an employee but an independent contractor.

Best Practices

As always, best practices in the discrimination area include the promulgation and dissemination of appropriate anti-discrimination policies and handbooks that reflect these policies, the proper training of management and employees, periodic auditing

of the practices and procedures used to implement these policies, and, above all, a "no tolerance" attitude towards discrimination of any kind.

Given the new focus on independent contractors, an employer should be proactive and treat independent contractors as employees for this same purpose. Management should be trained in this regard, as should employees. All workers should have the anti-discrimination policies readily available, and complaint and remediation procedures should be distributed to all.

Employers must also exercise caution when outsourcing or utilizing independent contractors to provide services that may affect the terms and conditions of employees. Remember that if an independent contractor commits a discriminatory act, that act may be attributable to the employer. Since it is more difficult to control the actions of independent contractors, employers should utilize available incentives and sanctions to affect their conduct. In *Dunn v. Washington County Hospital*, the United States Court of Appeals for the Seventh Circuit stated that "[i]t is the use (or failure to use) [incentives and sanctions] that makes an employer responsible—and in this respect independent contractors are no different from employees."

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[1] Other laws and regulations similarly do not apply to independent contractors, such as most unemployment insurance and workers' compensation plans, and restrictions apply to the Family and Medical Leave Act ("FMLA"), the Occupational Safety and Health Act ("OSHA"), and the Employee Retirement and Income Security Act ("ERISA").

[2] *See Vizcaino v. Microsoft Corporation*, 97 F.3d 1187 (9th Cir.1996) (independent contractors were, in actuality, employees, and must be allowed to participate in stock purchase program and 401(k) savings plan).

[3] *Moore v. KTR Development LLC*, 09-CV-2925, 2009 BL 216393 (E.D.N.Y. Oct. 6, 2009).