

LABOR & EMPLOYMENT TRENDS: The Many Risks of Independent Contractor Misclassification

By Steven Andersen



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Over the last decade many industries have increasingly come to rely on independent contractors instead of traditional full-time employees, a trend that has only accelerated as a result of the recession. The arrangement can be a win-win—reduced cost for the business, greater flexibility for the independent contractor—but it also carries substantial risks.

State and federal scrutiny on misclassification of employees as independent contractors is on the rise. The U.S. Department of Labor recently set aside \$25 million to investigate independent contractor misclassification allegations. The Internal Revenue Service has launched a three-year program that will randomly examine 6,000 companies for misclassification violations, and boldly announced that it anticipates raising \$7

billion over the next 10 years through tighter enforcement.

“Those agencies are not alone,” says [Marie Burke Kenny](#), who leads the labor and employment law practice group at [Luce, Forward, Hamilton & Scripps LLP](#). “FedEx just settled claims that it had misclassified its drivers as independent contractors for \$3 million with the office of the Massachusetts attorney general. In California we’re hearing more and more from businesses that the California Employment Development Department and the Franchise Tax Board are knocking on their doors, asking for records to determine whether certain independent contractors are in fact employees.”

And then there are the lawsuits. Whether filed individually or as class actions, individuals who performed services under an independent contractor agreement increasingly allege that they were

misclassified, seeking back wages and benefits. Additionally, potential penalties and attorneys’ fees significantly increase the possible liability for businesses.

The broad spectrum of misclassification risks leaves many businesses perplexed and understandably alarmed. The consequences are dire, but the rules are anything but clear.

“This is not by any means a cut-and-dried area,” Kenny says.

The Duck Test

Even the most brilliantly drafted independent contractor agreement cannot fully protect employers from misclassification liability. Companies can require business licenses or stipulate that contractors provide their own equipment or tools, but ultimately they come up against a common-sense question of perception: Does this look like an employer-employee relationship?

Wage and Hour Class Action Litigation— Defeating Class Certification

When misclassification litigation does arise, the case usually hinges on class certification. Even if some individuals have valid claims, resolving the liability for a few employees is far superior to fighting a protracted class-action battle. Analyzing the class for weakness or dissimilarity is the first step in fighting certification.

“The first thing you do is assess,” says Bernert. “You have to determine whether there are enough individualized issues that would predominate so that the case shouldn’t really be tried as a class action.”

A significantly weak case may be resolved quickly and inexpensively through summary judgment. Even in cases where there is some real liability, there’s often room to negotiate.

“How worried is the other side that they’re not going to get a class certified, or that you might actually defeat them on the merits?” asks Bernert. “You’ve got to know what kind of cards you’ve got to play. In any employment class action, you try to find a way to argue that a class is not the right class.”

Reclassification Pitfalls

Getting it right requires comprehensive preventive effort. Because of the gray areas in classification of independent contractors, Kenny recommends that companies using independent contractors in any capacity conduct a self-audit to determine whether anyone has been misclassified.

“You want to talk to your individual workers who are misclassified as independent contractors before any attorney talks to them or knocks on your door,” she says. “Make sure that they are really doing what the agreement says they are supposed to be doing. Make sure there’s not too much control being exerted over them. Make sure all the traditional independent contractor factors are in place. If they aren’t, seriously consider reclassifying those workers as employees before you have someone file a class action.”

Reclassifying workers can include negotiating release agreements to resolve

“If the reality of the relationship between the individual and the business doesn’t look like what the agreement says, the court and the agencies aren’t going to pay any heed to the piece of paper that is the independent contractor agreement,” Kenny says.

Some of the biggest mistakes occur when an employer exerts too much control over the manner or means by which the individual renders service, such as requiring frequent meetings or training sessions, working on-site, excessive reporting, or even use of company business cards or uniforms. In other words, not treating contractors like talented professionals who are able to work independently.

“The degree of control has historically been the test,” says Kathryn A. Bernert, a Luce Forward partner who specializes in labor and employment litigation. “But lately we’re seeing more and more cases that turn on whether or not the function that these contractors perform is an integral part of the company’s business.”

Kenny cites cases that were litigated against FedEx Ground and Air Couriers International, which had outsourced delivery driving to independent contractors.

“In ruling that the drivers were employees, the courts said, ‘these drivers perform work that is an integral part of the business—delivering packages. If it’s an essential or integral part of the enterprise, that type of work should be performed by employees.’ In-house counsel should be aware that this is now a factor in deciding whether or not individuals are independent contractors,” she says.

Courts and regulators also look at whether the work in question requires specific talent or skills.

Traditionally, independent contractors have traded on their particular expertise. The more commonplace or routine the work, the more likely it is to draw misclassification allegations.

“When it comes right down to it, if it walks like a duck and quacks like a duck, it is a duck,” Kenny says. “It’s up to the business to make the business decision, but if it’s close to the line, the penalties and the cost of getting it wrong are significant.”

back liabilities so the company has a clean slate going forward. That process, too, requires caution and expertise.

“In some jurisdictions there are restrictions on how you enter into a release agreement with an individual for the release of back wages,” Kenny says. “It often has to be done in consultation with competent and expert outside counsel, so that you don’t, in the process of trying to prevent liability, inadvertently create even further liability.”

For example, in California it’s a misdemeanor to ask an employee to sign a release for back wages if they haven’t been paid all the undisputed wages that they are owed. Rhode Island requires a state agency’s approval of a release of back wages.

In any case, businesses must proceed with discretion and tact. A poorly handled reclassification not only threatens to create new legal problems, it may scare off talented and qualified professionals. The recession, after all, has everyone nervous about employment status.

“The climate has changed,” Kenny says. “The law, the increased enforcement and the pressure that people are feeling as a result of the economy, these are all factors. People who were not worried about benefits and other perks of employment are more worried about these things today.”

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Article Participants:

Marie Burke Kenny leads the labor and employment law practice group at Luce, Forward’s San Diego office. She is [Peer Review Rated](#) and can be reached at mkenny@luce.com.

Kathryn A. Bernert is a Luce, Forward partner who specializes in labor and employment litigation. She is based in San Diego and can be reached at kbernert@luce.com. She is [Peer Review Rated](#).

Luce, Forward, Hamilton & Scripps LLP is a full-service law firm with 160 attorneys located in six offices across California. The firm’s labor and employment group works with clients to avoid disputes via preventive counseling, and focuses on swift and cost-effective resolution when litigation is necessary.