If It Walks, Talks and Looks Like an Employee...

By Eli M. Kantor and Zachary M. Cantor

Identifying workers as independent contractors is a precarious undertaking. Many employers believe that labeling a worker an "independent contractor" will end the classification inquiry. The inquiry, however, will reach beyond definitions included in a contract. Whether a worker is properly classified as an independent contractor is based on multiple factors. And the standards for determining whether a worker is properly classified as an employee or independent contractor vary between federal and state law. Employers in California and now, out-of-state firms with workers in California, should pay heed to the increasing enforcement of this significant legal distinction.

According to the 9th U.S. Circuit Court of Appeals' recent decision in *Narayan v. EGL Inc.* 2010 DJDAR 10844, even out-of-state companies that operate in California must adhere to California's labor laws. In *Narayan*, EGL Inc. engaged in the business of air and ocean freight delivery services, and operated a network of 400 facilities in over 100 countries. Three residents of California drove freight pick-up and delivery trucks for EGL in California. The drivers signed agreements stating that drivers were independent contractors, which included a provision designating Texas law to govern the contract. The drivers claimed that they were denied California-mandated overtime pay, expense reimbursements, and meal periods.

The court reasoned that the Texas choice-of-law provision only related to the terms of the contract itself. Indeed, the drivers' claims did "not arise out of the contract, involve the interpretation of any contract terms, or otherwise require there to be a contract." Rather, the drivers' claims concerned entitlement benefits under the California Labor Code. Whether the drivers were entitled to those benefits turned on whether they were EGL employees.

This decision is noteworthy because the court found that California law, and not contracts between workers and their employers, governs whether workers are independent contractors or employees. And California's Labor Code is designed, in part, to defeat employer attempts to evade its protections with "independent contractor" agreements.

Therefore, even out-of-state firms with operations in California should be familiar with California law. To be sure, any company operating in California should promptly audit their independent contractors to ensure they can withstand a government agency's investigation or a worker's lawsuit.

The state Supreme Court case of *S.G. Borello & Sons Inc. v. Dept. of Industrial Relations* (1989) 48 Cal.3d 341 is the definitive case in interpreting whether an individual is an employee or an independent contractor. *Borello* set forth several critical factors for courts to consider, including: the right to control the manner and means of accomplishing the results desired; the worker's opportunity for profit or loss depending on his managerial skill; the worker's investment in equipment or materials required for his task, or his employment of helpers; whether the service rendered requires a special skill; the degree of permanence of the working relationship; and whether the service rendered is an integral part of the alleged employer's business.

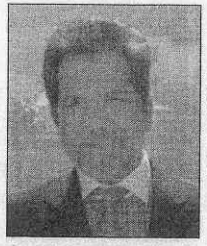
The *Borello* factors notwithstanding, an individual will likely be classified as an independent contractor when *the result of the work, and not how it is accomplished*, is the primary factor bargained for. That is, the right to control is the dominant factor. Moreover, the worker must be routinely engaged in an independently established business — and not merely deemed an independent contractor as a subterfuge to avoid employee status.

The consequences of misclassifying a worker as an independent contractor rather than an employee can be grave. *Vizcaino v. Microsoft* (9th Cir. 2002) 290 F.3d 1043 is a beacon to all employers to steer clear of worker misclassification. In *Vizcaino*, Microsoft labeled certain workers as independent contractors. The workers contended that their lengthy tenure at the company entitled them to benefits — such as participation in a 401(k) program and purchase of discounted Microsoft stock — like their co-workers. As 9th Circuit Judge Stephen Reinhardt observed in *Vizcaino*, "Large corporations have increasingly adopted the practice of hiring temporary employees or independent contractors as a means of avoiding payment of employee benefits, and thereby increasing their profits." Judge Reinhardt's political commentary aside, the *Vizcaino* decision is a warning to employers of the possible dire consequences of worker misclassification. The *Vizcaino* court held that those workers, originally hired as independent contractors, were entitled to benefits under Microsoft's 401(k) plan (the "Savings Plus Plan") and Microsoft's Employee Stock Purchase Plan. After over a decade of litigation, Microsoft settled the Vizcaino case for $97 million. Microsoft has no doubt revamped its employment practices.

Worse than disgruntled workers seeking redress are state officials obliged to fatten starving state coffers. While workers may file a lawsuit only if the stakes are high, the state has the resources and financial motives to clean out even the smallest offenders. Since raising taxes is taboo, California will ostensibly resort to any other means of raising revenue — especially in the midst of a recession and looming fiscal collapse. Stricter law enforcement is the most politically efficient option.

Indeed, the California Labor Commissioner and the Employment Development Department are cracking down on employers who misclassify workers as independent contractors. The California Attorney General recently recouped millions of dollars from building contractors, transportation firms and cleaning companies. These firms misclassified their workers as independent contractors or as corporate shareholders in order to bypass workers compensation requirements. Such enforcement will likely intensify as the state budget is squeezed. That is why employers must understand the difference between an employee and an independent contractor, and classify workers accordingly.

The sword of Damocles need not hang so heavy over companies with workers in California. Such firms need only examine their labor practices through the lens of *Borello* — or else suffer Microsoft's fate, if not government scrutiny. In any case, rest assured that a meticulous audit could preempt the burden of costly litigation.



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