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New Court Decision Increases Risk of Contractor Misclassification Claims

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In previous Advisories, we have discussed the government's increased scrutiny of independent contractor classifications as part of its effort to collect the payroll taxes that may be owed if workers are classified improperly as contractors. The risks caused by improper contractor classifications are not limited to government claims for payroll taxes, however. A new federal court decision illustrates the risks that arise from claims asserted by the contractors themselves, and demonstrates the ineffectiveness of one technique used by some employers in an effort to limit their risk of liability.

In Narayan v. EGL, Inc., a group of truck drivers sued EGL, contending that they had been misclassified as independent contractors and seeking overtime pay and other benefits they would have received if classified as employees. The drivers all worked in California, but had signed agreements supposedly confirming their status as contractors and agreeing that their contracts would be interpreted and enforced under the laws of Texas, the state in which EGL's headquarters is located. After the court initially applied Texas law and dismissed the suit, the drivers appealed. The appellate court reversed the decision to dismiss the case, holding that the drivers' claims should be resolved under California law (which is more protective of employees on many issues), since the claims arose under the California Labor Code. The appellate court emphasized that the proper classification of the drivers under California law was dependent on a number of factors, but added that the that the contractual provision through which the drivers' supposedly acknowledged their status as contractors was "not significant."

The *EGL* decision highlights the fact worker classifications are determined by applying specific criteria dictated by law, and the fact that employers have little ability to immunize themselves from liability for improper classifications through contractual agreements. In order to reduce their risk of liability under claims asserted either by a government entity or by workers themselves, employers should review their contractor classifications and consider their options carefully if a likely misclassification is identified.

Unfortunately, the law does not utilize a single test to differentiate employees from independent contractors for all purposes. In other words, the criteria used to distinguish employees from independent contractors for the purpose of federal income taxation are not necessarily the same criteria used to distinguish between employees and independent contractors for overtime or workers' compensation purposes. Although many of the tests used to determine status as a contractor or employee vary slightly from one another, some factors are considered in all (or almost all) of the different contexts in which the question comes up. Courts and government agencies examine each of the relevant factors with the objective of assessing the degree of control exercised by the employer over the individual in question. The exercise of strong control, or the ability to exercise strong control, is characteristic of an employment relationship, rather than a contracting relationship.

Among the factors which are most important in assessing the extent to which an individual is subject to a company's control, and which are most often ignored or misunderstood by employers, are the following:

- Continuing relationship- independent contractors generally do not have continuing relationships with the hiring party, while employees do;
- Work for multiple firms- independent contractors are generally free to work (and often do work) for more than one firm at once, while employees usually do not;
- Services available to the public- independent contractors generally offer their services to the general public, while employees do not; and
- Integration- a business' ability to operate generally does not depend upon the service of independent contractors. If a company's would be unable to operate, or would face substantial difficulty in operating, without a particular worker or group of workers, the importance of those workers weighs in favor of employee status.

As the court stated in the EGL decision, the intent of the parties is not a significant factor in determining one's status as an employee or contractor. The fact that parties may wish to characterize a worker as a contractor carries little weight in the determination process.

Analysis of the relevant factors is something of an art, rather than a science. No single factor is controlling, and no minimum number of factors is required to assure status as an employee or contractor, although an individual is very unlikely to be considered a contractor if a majority of the relevant factors suggest employee status.

What should you do now?

In order to minimize their risk of liability, employers should review their contractor classifications (particularly those most likely to be scrutinized in an audit or challenged in litigation) in light of the relevant legal criteria. The risk of misclassification is particularly high in two common scenarios- that of the former employee now working as a contractor, and that of the contractor who performs the same work as others who are classified as employees. In either of these relatively common scenarios, the risk of a misclassification is very significant.

In the event that a company identifies an individual who is probably misclassified as an independent contractor, it should confer with counsel to discuss the options available to it. Whether to re-classify a worker, and whether to pay any wages that might be owed to one who was misclassified, are sensitive issues. A poorly conceived remedial plan, or a poorly executed plan, can further increase an employer's risk of liability.

If you have any questions regarding independent contractor classifications, or any other employment law issues, we invite you to contact one of our attorneys:

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