BakerHostetler

Independent Contractor Misclassification:

2016 Legal Analysis

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The millennial workforce and the emerging gig economy have provided forward-thinking companies the opportunity to build business models that rely on a nontraditional, independent contractor workforce. Contractors and companies value the flexibility of the contractor model, and companies like Uber and Lyft have embraced it wholeheartedly.

1930s-era wage and hour laws, however, threaten to bring these business models to a crashing halt. Major lawsuits in 2015 against Uber and Lyft allege that independent contractor drivers were misclassified and, instead, are really employees under various employment laws. Delivery companies and retailers have been hit with similar lawsuits, alleging that their independent contractor drivers and installers are also misclassified. Even professional cheerleaders and exotic dancers made headlines in 2015 as class action plaintiffs.

Trending into 2016, independent contractor misclassification claims are being filed with increasing frequency, and the dollars at stake are game-changers. Multimillion-dollar settlements and judgments are commonplace. State and federal governments are initiating audits and investigations with increased vigilance, having determined that they are missing out on millions of dollars in tax revenue, unemployment and workers' compensation system funds, and penalties.

The Department of Labor has made independent contractor misclassification a priority enforcement area in 2016, and companies that are not prepared may be blindsided.

This white paper examines the legal landscape for companies that use independent contractors. It identifies advantages and disadvantages of the contractor model, analyzes the legal tests and risks, and provides 10 takeaways for companies that are using independent contractors.

Companies that plan ahead can often improve their chances of surviving a misclassification challenge. Although contractor misclassification claims are becoming increasingly difficult to defend, companies that are well prepared in 2016 will be better positioned to defend – or prevent – class action lawsuits and government actions alleging that independent contractors are employees in disguise.

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About the author

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I. INTRODUCTION

> MR. BURNS: And so our Employee of the Month is the late Roger Ducette, who tragically died from complications due to union organizing. Moving on. The power plant's first annual Fourth of July picnic is this coming Saturday.
> HOMER: Woo-HOO!
> MR. BURNS: Oh, I'm afraid you misunderstand. This picnic is for me. You will all be spending your Independence Day slaving away in the hot summer sun with no pay, lotion, or gratitude.[1]

Once upon a time, companies knew who their employees were. Since 1989, Homer, Lenny, and Carl have been punching the clock at Springfield Nuclear Power Plant, presumably being paid through Montgomery Burns' human resources and payroll departments. Waylon Smithers may or may not be exempt as Mr. Burns' executive assistant, but there is little doubt he is an employee. Whether or not the safety violations in Sector 7G are ever resolved, Homer continues to get a regular paycheck, even if he has to work on the Fourth of July.

Today's economy, however, is not so simple. Today there are direct employees, joint employees, staffing agency employees, temps to hire, independent contractors, consultants, leased workers, professional employer organizations, and contract workers. Workers that consumers might associate with a certain company or assume are employees are not necessarily treated as employees. Delivery drivers, passenger drivers, cabinet installers, cable installers, newspaper carriers, and even exotic dancers and NFL cheerleaders have been plaintiffs in high-profile class action litigation, with the workers alleging that they had been misclassified as independent contractors.

The question "*Who is my employee?"* is not always easy to answer. Government agencies have joined the plaintiffs' class action bar in aggressively challenging the legitimacy of many nonemployment work relationships. To answer the question "*Who is my employee?"* a company must be prepared to analyze multiple facets of its relationship with these workers, and the fact that a signed independent contractor agreement may be in place is generally of little value. The facts of the relationship are what matter, regardless of how the parties choose to classify the relationship.

Most of the employment laws that labor and employment lawyers regularly scrutinize apply only to employees, not to independent contractors. A finding of misclassification, therefore, can mean that the full panoply of employment laws that companies assumed were inapplicable suddenly apply. The consequences of past noncompliance can be staggering, both financially and in terms of disruption of a company's business model.

This white paper addresses a variety of issues associated with worker misclassification – or more specifically, the legal determination of whether a nonemployee worker is really an employee under applicable law.

This paper will focus on the practical and legal issues associated with using a nonemployee workforce, the various tests for determining whether workers are misclassified, and finally, some suggestions for minimizing the risks of misclassification.

[1] *The Simpsons*, "American History X-cellent," Season 21, Episode 17, Twentieth Century Fox Home Entertainment.

A. CONTINGENT WORKFORCE MODELS

The phrase "contingent workforce" can take on many meanings, but it generally refers to the use of nonemployee workers. At a most basic level, there are three major categories of workers who can perform services for a company:

(1) The Company's Employees. These are the workers who are unquestionably the company's employees. Their pay is reported on a Form W-2, they complete all immigration paperwork upon being hired, they are paid directly by the company, and deductions for taxes and withholding are taken from their paychecks. This paper is not about this category.

(2) Independent Contractors. These are workers retained as nonemployees. They are paid in gross, and their compensation is reported on a Form 1099. They are not eligible for employer-sponsored health benefits, stock plans, 401(k) contributions, or other employer-sponsored benefits. Independent contractors sometimes present themselves as individuals and sometimes present as sole proprietors of their own business or act on behalf of an LLC they have created. Independent contractors are sometimes paid under their individual names and are sometimes paid through a small-business entity they may have created, often for the sole purpose of taking on the particular independent contractor assignment being offered.

(3) Someone Else's Employees. These are workers who are clearly someone's employees and are being paid subject to withholding and deductions, reportable on a Form W-2, but generally their primary employer is a staffing agency or a consulting firm or another business. These workers are providing services for the benefit of a company other than the employer that is issuing their paychecks. Workers in this category typically include project consultants, contract workers, leased workers, and temporary (temp-to-hire) workers, or those doing outsourced functions such as janitorial services, security services, window washing, or landscaping.

The latter two categories are the focus of this white paper.

With respect to independent contractors, this paper will assess the increasing risk that such workers may be deemed misclassified – in other words, that a government agency or court may determine that an independent contractor was functioning as an employee and that the company, by failing to treat and pay that contractor as an employee, has violated one or more laws, commonly in the areas of employment, benefits, or taxes.

With respect to Someone Else's Employees, the primary risk is a finding of joint employment. These workers are already being treated by one entity as an employee, their paychecks are therefore already subject to deductions and withholding, and their pay is already reported on a Form W-2. Workers in this category, however, may be deemed joint employees of both their primary employer and the company for which they are providing services. Joint employment carries with it the possibility of unexpected liabilities and responsibilities for the company benefiting from the services. Under an August 2015 National Labor Relations Board decision, joint employment also carries with it a substantially increased risk that both the primary employer (e.g., a staffing agency) and the company benefiting from the services may be deemed joint employers for collective bargaining purposes and for purposes of determining a proper bargaining unit.[2]

[2] *Browning-Ferris Indus. of California*, 362 NLRB No. 186 (Aug. 27, 2015).