CLASSIFICATION OF WORKERS AS INDEPENDENT CONTRACTORS OR EMPLOYEES

PRESENTED TO THE _____

I. INDEPENDENT CONTRACTORS

Introduction*

Independent contractors are self-employed individuals who are retained by the employer on a contract basis to perform specified tasks. They are usually compensated on a contract or fee-for-service basis, issued 1099s, and are free to contemporaneously render services to other companies.

The use of independent contractors provides many advantages to employers. However, many employers do not appreciate the fact that there are substantial legal risks associated with utilizing independent contractors, as well as temporary, leased, and outsourced workers. Employers should not enter into an independent contractor relationship without first undertaking a thorough analysis of the parties' respective legal obligations.

From the independent contractor's perspective, that relationship provides an opportunity for the contractor to focus that individual's entire efforts on his/her area of expertise, and to maintain control over when, where, and for whom services will be performed. It also affords the contractor the opportunity to service different clients and customers in creative ways that are of the contractor's choosing.

While independent contractor status provides clear benefits to companies and individuals, that status has often been attacked by governmental regulatory agencies. While the Internal Revenue Service (IRS) traditionally has been hostile toward independent contractors, other governmental agencies have aggressively attacked contractor designation, including the U.S. Department of Labor (DOL), the Equal Employment Opportunity Commission (EEOC), the National Labor Relations Board (NLRB), and state agencies charged with administering the state's unemployment program, e.e.o. laws, and the like. Further, independent contractors themselves have attacked independent contractor status designations in order, for example, to qualify for employee stock options, to recover workers' compensation benefits and to obtain access to employee benefit programs maintained by the company for which they perform services, among other reasons. See *Vizcaino v. Microsoft*, 173 F.3d 713 (9th Cir. 1999), cert. denied, 2000 U.S. LEXIS 479.

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* Note: This document is designed to provide accurate and authoritative information with regard to the subject matter covered. It is distributed with the understanding that it does not constitute the rendering of legal or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

I. GUIDANCE REGARDING INDEPENDENT CONTRACTOR CLASSIFICATION STANDARDS (AND THE CONSEQUENCES OF MISCLASSIFICATION) UNDER SELECTED FEDERAL LAWS

A. Tax Laws.

1. Overview. There are a variety of relationships, and job titles, in the American workplace. For tax purposes, workers fall into one of two classifications: employee or independent contractor. The classification of a worker as an employee or independent contractor has significant tax consequences. Differences include withholding and employment tax requirements, as well as the ability to exclude certain types of compensation from income. Some of these consequences favor employees and some favor independent contractors. For example, an employee may exclude certain employee benefits from his or her gross income, whereas an independent contractor must establish his or her own pension plan. An independent contractor has more latitude in deducting work-related expenses.

As noted above, the determination of whether a worker is an employee or an independent contractor is made under an "individual facts and circumstances" test that basically seeks to determine whether the person is subject to the control of the employer.

2. Employment Taxes. One reason why the IRS is concerned with the misclassification of workers is the loss of employment taxes to the Federal government that occurs when workers are classified as independent contractors. There are three types of employment taxes, income tax withholding (I.R.C. Sections 3401-3406), "FICA" (*i.e.* Federal Insurance Contribution Act payments under I.R.C. Sections 3101-3128, and FUTA (*i.e.* Federal Unemployment Tax Act payments under I.R.C. Sections 3301-3311).

(a) Income Taxes. Theoretically, the Federal government should not sustain a loss on income taxes on the compensation payable to independent contractors because they presumably report their 1099 income on their personal income tax returns. However, an IRS survey in 1984 revealed that when workers were classified as employees, more than 99% of wage and salary income was reported, but when workers were classified as independent contractors, only 77% of gross income was reported when a Form 1099 was filed, and only 29% of gross income was reported when no Form 1099 was filed by the employer.

Under Section 3403 of the I.R.C., the employer is liable for the payment of income taxes, whether or not the taxes were actually withheld.

(b) F.I.C.A. F.I.C.A. taxes, commonly called "social security" taxes, are withheld from an employee's pay, and the employer must pay a matching F.I.C.A. tax equal to the employee's portion. Therefore, the Federal government does suffer a net loss on its F.I.C.A. contributions when a worker is classified as an independent contractor.

(c) F.U.T.A. F.U.T.A. is also assessed on all wages, and the employer is liable for such tax payments if they are not withheld from an employee's pay.

3. Employee Benefit Plans. The classification of workers as independent contractors or employees is also significant for purposes of determining whether the I.R.C. coverage requirements are met for qualified retirement plans and certain employee benefit plans. See *e.g.* I.R.C. Sections 410(b) and 105(h). Generally, these provisions require that the sponsor of the plan must cover at least a minimum percentage of the sponsor's "employees". In *Kenney v. Comm'r,* 70 T.C.M. 614 (1995), a retirement plan was disqualified because it failed to benefit a sufficient number of non-highly compensated employees as a result of the mischaracterization of workers as independent contractors.

On the flip side, in order for an independent contractor to make contributions to a Keogh plan, he must be an independent contractor. See *Herman v. Comm'r,* 52 T.C.M. 1194 (1986).

4. Miscellaneous. Independent contractors are eligible for certain income tax deductions that are not available to employees (*e.g.* professional dues and subscription costs). Independent contractors are not subject to the more narrow definition of "business use" applicable to employees, and therefore may enjoy more latitude in deducting certain expenses attributable to a dwelling unit, and in obtaining investment tax credit or recovery deductions applicable to certain property.

5. Classification Standards under the Internal Revenue Code. Under I.R.C. Section 3121(d)(2), individuals will be classified as employees for F.I.C.A. purposes if they would be treated as employees "under the usual common law rules applicable in determining the employer-employee relationship". For purposes of classifying workers under this "common law" test, the IRS has historically relied upon the 20 factor test set forth in Rev. Ruling 87-41, 1987-1 C.B. 296.

Under I.R.C. Section 3121(d)(1), officers of a corporation are automatically treated as employees for F.I.C.A. purposes. See *Western Management v. United States*, 2000-1 U.S.T.C. ¶ 50,186 (Fed. Cl.Ct. 2000). But the IRS has acknowledged that a corporate officer who performs no services or only minor services may not be considered a statutory employee. See *C.C.A.* 200009043.

The courts have focused primarily on 7 of the 20 factors set forth in Rev. Ruling 87-41:

a. The degree of control exercised by the principal over the details of the work.

b. Which party invests in the facilities used in the work.

c. The opportunity of the worker for profit or loss.

d. Whether the principal has the right to discharge the worker.

e. Whether the work is part of the principal's regular business.

f. The permanency of the relationship.

g. The type of relationship that the principal and worker believe they are creating.

The overriding consideration for both the Internal Revenue Service and the courts is the level of control over the worker, most other factors being considered as evidence of whether such control exists. The IRS has issued guidelines for the classification of limousine drivers, and these guidelines are useful in determining what the IRS will view as "excessive" control over independent contractors. See BNA Daily Tax Report, 4/23/97, p. L-2 through p. L-11. In these guidelines, the IRS said that the following instructions are consistent with independent contractor status "because they are related to the results of service to be accomplished rather than to the manner of accomplishing the service, or because they are primarily related to factors such as passenger safety, comfort, and security":

1. Where and when to pick up passengers, and where to drop them off.

2. Reasonable parameters for age, color, and capacity of vehicles and requirement that vehicle be clean, safe, and upscale.

3. Requirement that company logo be displayed in or on the vehicle and that driver wear a suit, white shirt, and tie.

4. Requirements regarding communications protocols.

5. Requirements regarding processing of charge slips and accounting to the company for passenger revenues that are to be divided between the driver and the company.

6. Dispatching protocols (*e.g.*, allocation of jobs by geographic location of vehicle and availability of driver, or other neutral standards).

7. Requirements regarding the reporting of accidents and customer complaints.

Instructions which the IRS said were <u>not</u> consistent with independent contractor status "because they were related to how the service was to be accomplished" included the following:

1. Requirements prescribing routes of travel (except as required by customers) and specific holding areas, where limousine drivers wait during periods of inactivity (except as required by third parties, such as municipalities and airport authorities).

2. Requirements fixing work hours, prescribing a minimum number of work hours, daily or weekly number of jobs, or otherwise fixing the driver's work schedule.

3. Requirement that drivers accept all jobs offered to them by the limousine company.

4. Requirement that drivers refrain from using vehicle for personal reasons.

5. Requirement that drivers use certain suppliers for insurance, fuel, or repairs.

6. Requirement that driver perform all services personally and not substitute other drivers.

7. Requirement that drivers stock their cars with specific food and drink items, reading materials, umbrellas, etc.

8. Requirements regarding how the driver should greet passengers and load passengers.

Note that the courts have given no weight to instructions given by an employer in order to comply with other Federal laws such as Department of Transportation license requirements.

6. <u>Section 530 of the Revenue Act of 1978.</u> Since 1978, the classification of workers for employment tax purposes has refocused on the Section 530 "safe harbor" statute. Section 530, Revenue Act of 1978, P.L. 95-600, November 6, 1978, as amended.

The purpose of Section 530 is to prevent the IRS from retroactive application of the reclassification of a worker as an employee, as long as the employer meets certain tests. The section does not address how a worker is to be classified, but merely relieves the employer of liability for employment taxes even where it is determined that the worker was an employee.

In part, Congress adopted Section 530 in order to put a hold on the IRS's plans to issue regulations aimed at determining employment status. See Conference Report to the 1978 Revenue Act, H.R. Rep. No. 1800, 95th Congress, 2nd Session (1978). Although the issuance of IRS regulations may have helped settle this unsettled area of the law, the issue is inherently subjective, and Congress may have been concerned that the IRS regulations would have been overly conservative.

While Section 530 has not been incorporated into the Internal Revenue Code, it has been indefinitely extended, and has permanently altered the analysis of worker classification. Case law now focuses on the taxpayer's attempt to gain relief under Section 530 and is no longer limited to an examination of the factors historically used to determine whether a worker was an employee or independent contractor.

Under Section 530 of the Revenue Act of 1978, a taxpayer will be protected from retroactive assessment of employment taxes based on reclassification of workers as employees if the taxpayer can demonstrate reasonable reliance upon any one of the following three safe harbors:

1. Judicial precedent or published rulings, or technical advice, a private letter ruling or a determination letter pertaining to the taxpayer;

2. A past IRS audit of the taxpayer if the audit did not result in the assessment of employment taxes as to the workers in question; and

3. A long-standing, recognized practice of a "significant segment" of the taxpayer's industry in treating workers of the type in question as independent contractors.

The first two safe harbors, judicial precedent/prior rulings, and prior IRS audits, are fairly cut and dry. Most of the controversy takes place under the third safe harbor, whether a long-standing, recognized practice exists. Not surprisingly, the IRS has taken a much more restrictive approach than the courts. In private letter ruling 9619001 (1996 P.R.L. LEXIS 118), the IRS held that the taxpayer had failed to establish a long-standing, recognized industry practice of treating workers as independent contractors where 21 of the taxpayers' 24 competitors classified their drivers as independent contractors.

7. <u>The IRS Manual for Worker Classification</u>. The IRS prepared new training manuals to address recent developments affecting worker classification issues, and those materials were reprinted in the BNA Daily Tax Report, 8/5/96, p. L-1 through p. L-48. Most enlightening in that training manual is the chart which IRS agents are to use in determining whether the employer exercises a sufficient amount of control in order to reclassify independent contractors as employees. The chart reads as follows:

Behavioral Control	Facts which illustrate whether there is a right to direct or control how the worker performs the specific task for which he or she is hired: • instructions • training
Financial Control	Facts which illustrate whether there is a right to direct or control how the business aspects of the worker's activities are conducted: • significant investment • unreimbursed expenses • services available to the public • method of payment • opportunity for profit or loss
Relationship of the Parties	Facts which illustrate how the parties perceive their relationship: • employee benefits • intent of parties/written contracts • permanency • discharge/termination • regular business activity

B. <u>Workers Compensation Issues</u>. Recovery of workers compensation benefits is one of the most fertile grounds for worker classification controversies. Theoretically, independent contractors would not be covered under an employer's workers compensation policy because they are independent businesspersons, not employees. Independent contractors should secure their own workers compensation or occupational accident insurance. Employers are best served by securing a group policy for their fleet, and collecting the premiums for such insurance directly from their independent contractors (which may be deducted from the contractor's settlement checks).

Decisions of the workers compensation boards vary considerably by state, and by the particular facts of the case. As in the Federal tax context, the principal issue is whether the employer reserves the right to direct or control the worker.

When completing workers compensation forms for independent contractors, employers must be careful. For example, pre-printed forms will generally refer to "employers" and "employees". When completing these forms for an independent contractor, the employer should either cross out the pre-printed words "employer" and "employee", or note somewhere on the form that the person applying for benefits is an independent contractor. A well-drafted independent contractor agreement will include a provision that requires the independent contractor to maintain his or her own workers

compensation insurance as required by state law (in which case, the company will be taken out of the claims process altogether).

As noted in Section K below, when contracting with a third party like the Independent Contractor Advantage, Subcontracting Concepts, Inc. or NICA, Incorporated, it is wise to use the same insurance company for the delivery company's worker compensation and the third party supplier's occupational accident insurance - in this way, the insurance company will have no incentive to reject the independent contractor's claim under his occupational accident policy.

C. Federal Labor and Employment Laws

Virtually all federal employment statutes provide particular protections to "employees." Federal courts generally apply an "economic realities" test in determining whether a worker is an employee under most employment discrimination statutes. See e.g., *Knight v. United Farm Bureau Mut. Ins. Co.*, 950 F.2d 377, 380 (7th Cir. 1991). The economic realities test examines five factors:

1. The degree of control exercised by the company over the worker;

2. The permanency of the working relationship;

3. The degree of skill required to perform the work;

4. The worker's investment in the facilities for work; and

5. The worker's expectation for profit or loss.

The determination as to whether an independent contractor or temporary or leased worker is an "employee" has two important consequences under many federal employment laws. First, because only "employees" count toward the numerical thresholds for the application of certain statutes, the determination impacts whether the employer is subject to such laws as the Americans with Disabilities Act ("ADA"), the Age Discrimination in Employment Act ("ADEA"), and Title VII of the Civil Rights Act of 1964 ("Title VII"). See e.g., *Martin v. United Way of Erie County*, 829 F.2d 445 (3d Cir. 1987). Second, because most statutes protect "employees" in a specified way, the determination whether a worker is an "employee" will determine whether (s)he is entitled to pursue particular remedies available under the statues. See e.g., *Mallare v. St. Luke's Hospital*, 699 F. Supp. 1127 (E.D. Pa. 1988), and the various statutory "remedies" discussed below.

D. Fair Labor Standards Act

The Fair Labor Standards Act (FLSA) was enacted to protect employees from substandard wages and excessive hours. 29 U.S.C. § 201 *et seq*. FLSA minimum wage, overtime, equal pay, and child labor protections apply, inter alia, to employees of private

sector employers who are engaged in interstate commerce. 29 U.S.C. §§ 203, 206, 207, 212.

FLSA's protections apply only to employees, but the FLSA defines the term broadly. 29 U.S.C. § 203(e), (g). An *employee* is defined as any individual employed by an employer, i.e., one who is permitted to work. *Rutherford Food Corp. v. McComb*, 67 S. Ct. 1473 (1947), 331 U.S. 722, 727 (1994).

The U.S. Supreme Court held in *Rutherford* that the traditional common law criteria were not broad enough to determine whether a worker was an independent contractor or a protected employee for FLSA purposes. Rather, the court concluded that a more appropriate test would include an examination of the underlying "economic realities" of the working relationship.

The U.S. DOL, which enforces the FLSA, interprets the Supreme Court's economic realities test to provide that the primary consideration is whether the engaging entity controls or has the right to control the work to be done by the worker to the extent of prescribing how the work shall be performed. DOL recognizes that a determination of a worker's status cannot be based on isolated factors or a single characteristic but must take into account "the circumstances of the whole activity."

To determine whether the "right to control" exists, DOL emphasizes the following factors: (1) the extent to which the services in question are an integral part of the employer's business; (2) the amount of the contractor's investment in facilities and equipment; (3) the contractor's opportunities for profit and loss; and (4) the amount of initiative, judgment, or foresight in open-market competition with others required for the success of the claimed independent enterprise.

Additional factors considered by DOL include: (1) whether the contract gives any right to the engaging party to detail how the work is to be performed; (2) whether the engaging party has control over the business of the contractor; (3) whether the contract is for an indefinite or relatively long period; (4) whether the engaging party may discharge the contractor's employees; (5) whether the engaging party has the right to cancel the contract at will; and (6) whether the purported independent contractor is performing work that is the same or similar to that performed by the engaging party's employees.

DOL regards certain factors as immaterial to the determination of employee status, including, for example, whether the worker has a governmental license; the measurement, method, or designation of compensation; the fact that no compensation is paid and the worker must rely entirely on gratuities; the site where the work is performed; and the absence of a formal employment agreement.

Remedies:

As indicated above, the consequences of incorrect classification can be severe, and the incorrectly classified employee is entitled to all remedies under the law for the

underpayment of wages, including unpaid overtime. These remedies may include, for example, fines against the employer for record-keeping violations, and back pay for the misclassified employee for up to two years, unless the employer "knew or showed reckless disregard for the matter of whether its conduct was prohibited by the FLSA," in which case three years of back pay could be applicable. A successful plaintiff may also be entitled to attorney's fees, court costs, interest, and liquidated damages in an amount equal to lost wages unless the employer can prove that it acted in "good faith" and with "reasonable grounds" to believe it was complying with the FLSA. Aggravated violations can result in criminal prosecution. (The Equal Pay Act essentially provides the same civil penalties for such violations affecting misclassified employees as are applicable to FLSA violations).

Note: Keep in mind that a company also can be held responsible for complying with the FLSA with respect to any worker by application of the "joint employer" doctrine. See *e.g., Baystate Alternative Staffing v. Herman*, 163 F.3d. 668 (1st Cir. 1998) (holding a leasing firm and client company to be joint employers with respect to leased workers for purposes of the FLSA).

E. Title VII of the Civil Rights Act of 1964

Title VII bars employment discrimination on the basis of race, color, religion, sex (including pregnancy, childbirth, and related medical conditions), and national origin with regard to applicant screening, hire compensation, promotion, classification, training, apprenticeship, referral for employment, discipline, discharge, and other terms, conditions and privileges of employment, and employment opportunities. Title VII applies, inter alia, to private sector employers having at least 15 employees. The EEOC enforces Title VII administratively.

Under Title VII, courts generally apply the "economic realities" test or the common law agency test to determine whether a worker is a contractor. While each test is technically different, both accord substantial weight to the employer's right to control. Determinations produced by both approaches may well result in the same finding.

The importance of consistently engaging independent contractors by a written agreement has been underscored in several decisions. See e.g., *Adcock v. Chrysler Corp*., 166 F.3d 1290 (9th Cir. 1999), *cert denied*, 120 S. Ct. 55 (1999). In that case, a Title VII claim asserted by a prospective employee was rejected based on the court's determination that the individual would have been engaged as an independent contractor. The court relied on a draft of the agreement that the company used when engaging others for a similar position.

Remedies:

Misclassified contractors who are deemed to be statutory employees under Title VII may sue for discrimination under that law. Violations of Title VII may result in an injunctive and affirmative relief, including compensatory damages, reinstatement, back

pay for two years, other "make whole" remedies, front pay where reinstatement is not feasible, punitive damages subject to federal caps, attorney's fees, and court costs.

Note further that Title VII liability may extend beyond the traditional employer-employee relationship. See *Moland v. Bil-Mar Foods*, 994 F. Supp. 1061 (N.D. Iowa 1998), which illustrates this third-party liability concept. *Moland* involved a plaintiff who was employed by IBP Corporation and asserted a Title VII claim against a different company, Bil-Mar Foods, for sexual harassment and unlawful retaliation for reporting same. The court held that plaintiff-Moland stated valid Title VII claims against Bil-Mar for sexual harassment and unlawful retaliation based on its finding that Bil-Mar's discriminatory conduct interfered with Moland's employment with IBP.

Similarly, in *Sibley Mem'l Hosp. v. Wilson*, 488 F.2d 1338 (D.C. Cir. 1973), the appeals court expressly recognized that Title VII coverage exceeds the traditional employment relationship:

To permit a covered employer to exploit circumstances peculiarly affording it the capability of discriminatorily interfering with an individual's employment opportunities with another employer, while it could not do so with respect to employment in its own service, would be to condone continued use of the very criteria for employment that Congress has prohibited.

Id. At 1341.

Title VII was also broadly applied in *Kudatzky v. Galbreath Co.*, 1997 U.S. Dist. LEXIS 14445 (S.D.N.Y. 1997). The court there held that an employer can be held liable under Title VII for the sexual harassment of its employee, even though the harasser was a nonemployee (i.e. an independent contractor), and the harassment took place at a client's location.

EEOC guidelines in this regard state:

> An employer may…be responsible for the acts of nonemployees, with respect to sexual harassment in the workplace, where the employer (or its agents or supervisory employees) knows or should have known of the conduct and fails to take immediate or appropriate corrective action.

In short, a company which utilizes contractors to perform services who interact with the company's own employees can be liable to its employees under Title VII for a contractor's sexual harassment.

F. Americans With Disabilities Act of 1990 ("ADA")

The ADA prohibits employment discrimination against individuals with disabilities in employment, public services, public accommodations, and telecommunications and requires public services and accommodations to be usable and

accessible by such individuals. The ADA's employment provisions cover employers with at least 15 employees and establish detailed employer non-discrimination and reasonable accommodation obligations vis a vis applicants for employment and employees with covered "disabilities." Note that virtually all states have laws prohibiting physical and mental disability discrimination against applicants and employees, some of which are more comprehensive than the ADA.

A worker's status under the ADA sometimes follows the test used in the jurisdiction under Title VII and, therefore, there is a split among the federal circuits between the common law test and the economic realities test.

A company defending against an ADA claim always should always explore the possible defense that the worker is not an "employee" covered by the statute in question, regardless whether the worker has been treated as an employee for tax and/or benefit purposes.

See *Hollingsworth-Hanlon v. Alliance Francaise of Chicago*, 1998 U.S. Dist. LEXIS 9448 (N.D. Ill. 1998), (unreported decision) which involved a claim asserted under the ADA by a part-time language teacher who was dismissed based on a determination that the teacher was an independent contractor. The determination was made despite the fact that the company had treated the teacher as an employee for purposes of federal employment taxes. The court applied the "economic realities" test and utilized the following factors: (1) control and supervision; (2) nature of occupation and skills required; (3) location and cost of operation and maintenance; (4) form of payment and benefits; and (5) length of job commitment and/or expectation. *Hollingsworth-Hanlon* underscores the critical importance of "control" in determining a worker's status under the ADA. That decision placed great weight on control over matters related to the performance of the worker's services (teaching), while disregarding the organization's control over administrative matters involving that individual.

Remedies:

Misclassified contractors can also receive the award of remedies under the ADA due to discrimination against them on account of a covered disability. These remedies are akin to those available under Title VII, and include injunctive and "make whole" relief, attorney's fees, and punitive damages subject to federal caps.

G. Federal Occupational Safety and Health Act ("OSHA")

Federal OSHA and state OSHA laws require employers to maintain a safe and healthy workplace. When independent contractors are used, the party in direct control over the workplace (and the actions of the contractor) may be cited under OSHA for safety violations in the workplace and is required to maintain records of illnesses and injuries (e.g. OSHA Form 300).

Under federal OSHA, employees of employers who are employed in a business that affects commerce are covered. 29 U.S.C. § 652(6). An independent contractor may be classified as an "employee" based upon the following factors: (1) Whom do the workers consider their employer? (2) Who pays the workers' wages? (3) Who has the responsibility to control the workers? (4) Does the alleged employer have the power to control the workers? (5) Does the alleged employer have the power to fire or hire the workers or modify the workers' employment conditions? (6) Does the workers' ability to increase their income depend on efficiency rather than initiative, judgment, and foresight? (7) How are the workers' wages established? See *Secretary v. Griffen & Brand of McAllen, Inc*. 6 O.S.H.C. (BNA) 1702 (1978).

Remedies:

Remedies against employing entities for OSHA violations include the full panoply of injunctive relief, fines, and even criminal penalties for willful criminal violations, employee death in certain circumstances, and for making false representations under the Act. Civil penalties are mandatory for "serious" violations and may escalate up to $1,000 per day for failure to abate dangerous conditions, and up to $10,000 for willful and repeated violations. There are also a number of remedies available to employees who prove unlawful discrimination for exercising their protected rights to a safe workplace. These remedies include reinstatement, back pay, and the restoration of lost benefits.

H. National Labor Relations Act ("NLRA")

The NLRA protects the rights of employees to organize unions, select collective bargaining representatives, and to engage in (or refrain from) concerted activities for the purpose of collective bargaining and other mutual aid and protection. 29 U.S.C. § 157.

Independent contractors are expressly excluded from coverage under the NLRA. To distinguish employees from independent contractors for purposes of the NLRA, the NLRB employs a common law agency test, frequently emphasizing the right-to-control element.

The NLRB may be required to determine whether a worker is a protected employee or an excluded independent contractor in the representation hearing context. The NLRB has described the right-of-control test as follows:

> In determining the status of person alleged to be independent contractors, the Board has consistently held that the Act required application of the right of control test. Where the one for whom the services are performed retains the right to control the manner and means by which the result is to be accomplished, the relationship is one of employment; while, on the other hand, where control is reserved only as to the result sought, the result is that of an independent contractor. The resolution of this question depends on the facts of each case, and no one factor is determinative.

News Syndicate Co., 164 NLRB 422, 423-24 (1967). See *Dial-A Mattress Operating Corp.*, 326 NLRB NO. 75 (1998), and *Roadway Package System, Inc.*, 326 NLRB No. 72 (1998), where the NLRB determined that it lacked the authority to depart from the common law test as the legal determinant of a worker's status under the NLRA. The Board also rejected an interpretation of the test that would have accorded increased weight to the right-of-control factors, holding instead that the NLRA requires a careful examination of all factors of the common law test.

In *Air Transit, Inc.*, 271 NLRB 1108, 1110-1111 (1984), the Board emphasized that the entrepreneurial factor of opportunity for profit or risk of loss strongly supported an inference of contractor status. The Board adopted the analysis of the D.C. Court of Appeals in *Democratic Union Org. Comm. v. NLRB*, 603 F.2d 862, 879 (D.C. Cir. 1978), where the court observed:

> When a [cab] driver pays a fixed rental [for the cab], regardless of his earnings on a particular day, and when he retains all the fares he collects without having to account to the company in any way, there is a strong inference that the cab company involved does not exert control over the means and manner of his performance.

The court observed that the cab company had no financial incentive to control the drivers' operations other than that necessary to immunize the company from liability it risked as a lessor of the cab. Under these circumstances, "[t]he surrender of the right to make the drivers account for their earnings causes a fundamental change in the relationship between the companies and their drivers which will usually remove the latter from the category of 'employees.'" *Id*.

Remedies:

In the event that individuals classified as contractors are found to be statutory employees under the NLRA, they will be afforded the right to organize, and are protected against anti-union discrimination by the employer. Remedies are typically limited to reinstatement, back pay, and restoration of benefits, although injunctive relief and contempt decrees for violation of court orders enforcing NLRB holdings can be available.

I. Worker Adjustment and Retraining Notification Act ("WARN")

Properly classified independent contractors are separate employers for purposes of the WARN Act, which requires advance notice to employees of impending plant closures and mass layoffs. Accordingly, independent contractors (and their assistants/employees) are not counted toward the threshold number of employees in determining whether WARN Act notice is required, and are not entitled to receive notice from the hiring entity, even if that coverage threshold has been met for that hiring company. According to the regulations implementing WARN, factors considered to distinguish independent contractors from employees for WARN Act purposes include the

actual exercise of control, unity of personnel policies emanating from a common source, and the dependency of operations. A fundamental question is whether the independent contractor is sufficiently independent of the hiring entity. 20 C.F. R. § 639.3(a)(2). See *Bradley v. Sequoyah Fuels Corp.*, 847 F. Supp. 863, 868 (E.D. Okla. 1994).

Remedies:

In the event that the WARN Act is applicable, the employer is liable to each aggrieved employee (including misclassified contractors) for back pay and benefits for the period of the violation, up to 60 days, and for civil penalties for failure to provide notice to the appropriate local government unit of up to $500 for each day of violation, as well as attorney's fees and costs in litigation to enforce WARN rights. In this context, as elsewhere, a court's reclassifying contractors as employees may push the hiring company's employee complement over the coverage threshold so as to implicate statutory WARN Act coverage.

J. Age Discrimination in Employment Act of 1967 ("ADEA")

The Age Discrimination in Employment Act ("ADEA") generally makes it unlawful for employers of at least 20 employees to:

- Limit or classify an employee because of age (at least 40 years of age) in any way that deprives or tends to deprive that individual of employment opportunities or otherwise adversely affects that person's status as an employee;

- Reduce the wage rate of any employee to comply with ADEA;

- Undertake any retaliatory action against an employee who has complained of age discrimination;

- Print or publish notices or advertisements for employment indicating any preference, limitation, specification, or discrimination based on age;

- Fail to hire, discharge, or otherwise discriminate with respect to compensation, terms, conditions, or privileges of employment because of age.

Remedies:

In addition to customary "make whole" relief to employees (including misclassified contractors) who are found to have been discriminated against on account of their age, the ADEA grants courts the ability to issue injunctions, as well as "front pay". Courts may also award liquidated damages in the amount of twice the plaintiff's actual damages if a violation is found to be willful.

In *EEOC v. Zippo Mfg. Co.*, 713 F.2d 32 (3d Cir. 1983), the U.S. Court of Appeals for the Third Circuit defined the standard to be applied in determining employee status under the ADEA as a hybrid of the common law "right to control" standard, and the "economic realities" standard applied to the Fair Labor Standards Act and the Social Security Act. The Court stated, "it is the economic realities of the relationship viewed in light of the common law principles of agency and the right of the employer to control the employee that are determinative." *Id*. At 37.

If there is a genuine dispute as to whether an employer-employee relationship exists under the ADEA, the issue is a matter for the jury. See e.g., *Hickey v. Arkla Industries, Inc.*, 699 F.2d 748 (5th Cir. 1983).

K. Contracting with Third Parties for the Furnishing of Independent Contractors.

There are a number of companies that specialize in the reduction of risk incident to misclassification of workers. A well-drafted agreement with such third parties will include the following:

(i) The third party will advertise for, and recruit, the independent contractors; screen and review their qualifications; ensure that they maintain adequate occupational accident insurance; and ensure that they comply with all state and federal regulations applicable to the operations to be conducted.

(ii) The courier company will pay the third party a fee for the services provided by the third party, and the third party should be solely responsible for paying all compensation to the independent contractors. The third party should be responsible for complying with any and all tax reporting, employment tax and related obligations with respect to the compensation which it pays to the independent contractors.

(iii) (And this is always a sore point) The payment by the courier company to the third party services should not be tied in amount and time to the compensation payable by the third party to the independent contractors. Many times, the third party supplier calculates the amount due to the contractors, tacks on its fee for services, and then requires the courier company to pay in that amount the day before the contractor's pay day. IRS agents will seize upon this fact to argue that the third parties are merely acting as the alter ego for the courier company, and reclassify the courier company as the employer, and the independent contractors as employees. It is preferable to have the courier company pay the third party supplier the same amount, at the same times, each month, which amount will approximate what the third party must pay out to the contractors. Alternatively, the courier company could secure its obligation to pay the third party supplier with a letter of credit to ensure that the supplier will be paid.

(iv) The third party should be required to enter into a written agreement with its independent contractors, and, among other things, that agreement should include

a waiver of any rights to participate in the courier company's employment benefit programs. Also, importantly, the agreement between the third party and the independent contractors should not include a non-complete clause running to the benefit of the courier company (that would be totally inconsistent with independent contractor status), but the agreement should include a broad confidentiality clause which restricts the contractors from contacting the courier company's customers during and after their engagement by such courier company.

(v) The third party should be required to indemnify the courier company from any employment tax or workers compensation liability relating to the independent contractors. However, note that most agreements with third parties require the courier company to refrain from any acts that could undermine the independent contractor status of the workers. Therefore, if a worker's classification is challenged, and it is ultimately determined that the worker was an independent contractor, the third party may disclaim its indemnification responsibilities based upon the "no undermining" clause. To minimize this risk, the courier company's agreement with a third party supplier should: (i) state that the third party is familiar with the operations of the courier company, and that such operations are not deemed to violate the "no undermining" clause; and (ii) require that the third party provide a legal defense to any challenge to the independent contractor status of the workers.

III. Basic Do's and Don'ts to Consider in Attempting to Create Independent Contractor Status:

DO:

- Permit the independent contractor to "bid" for a particular route, or a particular time slot for on-demand deliveries;
- Allow the contractor to work the hours he chooses;
- Allow the contractor to pick and choose the jobs he wishes to take;
- Pay the contractor by the job (*i.e.* for each trip billed);
- Allow the contractor to hire, and pay for, his or her own assistants;
- Allow the contractor to "hand off" work as he deems appropriate (consistent with other requirements under his independent contractor agreement);
- Supply new contractors with a brief orientation, different from a regular employee's orientation;

- Enter into an appropriate written independent contractor agreement, either with the contractor directly, or with a third party which will be supplying suitable contractors;

- File all required 1099 forms;

- Follow the industry standard in the competing marketplace (if you don't, your competitors will report you!);

DON'T:

- Mandate specific hours, prescribe a minimum number of work hours, or otherwise fix the driver's work schedule;

- Pay by the hour, week or month;

- Pay business or travel expenses, including uniforms, vehicle or bike repairs, radios, pagers or cell phones (it is usually alright to deduct these expenses from the contractor's "settlement checks");

- Provide vehicles, bicycles, or business equipment:

- Provide company employees to assist in the performance of the contractor's job:

- Require elaborate training; do not specify specific details as to how deliveries are to be made (see Section I A. 5. at pages 4-5 above regarding the IRS views as to acceptable instructions in the limousine industry);

- Make a promise of employment status; identify the independent contractor as a company employee; make the independent contractor subject to the company's employment policies or company handbook;

- Permit independent contractors to qualify for company fringe benefits;

- Mandate uniforms (unless required by the customer);

- Have the independent contractor report to the company's base office; entitle the independent contractor to use admittance card or keys to the company's principal place of business, or utilize company equipment, supplies, etc.;

- Terminate without cause (the contractor must be obligated to perform his job according to specifications set forth in the written contract, and termination is available only if the contract terms are breached);

- Include non-competition clauses (confidentiality clauses, and a prohibition against solicitation of customers is usually alright);

- Require elaborate oral or written reports, but rather "service advisories" designed to achieve greater customer satisfaction.

Note: In drafting and implementing independent contractor arrangements, it is strongly recommended that you contact professionals (*i.e.* lawyers and/or accountants) familiar with this issue and familiar with your industry.