

## Curbing an Employee Classification Mistake

***Misclassifying employees as independent contractors is costing employers, with increased litigation and regulatory action. A proactive approach can avoid missteps.***

By BENJAMIN STONE and DANIEL WARD, attorneys in the Seattle office of law firm [Cozen O'Connor](#) practicing in the Global Insurance Group

A slow-moving recovery matched with profound uncertainty about long-term economic conditions has increased the incentive for employers to hire independent contractors. But perhaps due to these same factors, company classification decisions are under attack--both by the workers themselves in litigation and by federal and state administrative agencies.

The financial stakes can be high for companies, with several high-profile businesses facing settlements in the millions. The dual purpose of this article is to provide a brief sketch of the issues raised by the most recent misclassification lawsuits and administrative actions and to provide recommendations for employers to avoid liability for worker misclassification.

### THE COURT FRONT

[FedEx](#) is one such high-profile company facing class-action misclassification lawsuits nationwide. In December 2008, FedEx reportedly settled a California class-action for approximately \$27 million. The settlement included \$14.5 million to 203 drivers who were improperly classified as independent contractors. More than 60 additional lawsuits against FedEx have been consolidated before a single judge in Indiana.

The company has received mixed results in this action. In a recent decision, the judge held that Illinois FedEx drivers were employees and not independent contractors based on several factors: the drivers were required to wear FedEx uniforms, they drove in trucks with company logos, and the testimony of former FedEx CEO Dan Sullivan indicated that the workers were a "centerpiece" of the FedEx workforce and an "essential part" of the business.

In another recent FedEx decision, the court decided that under Kansas law the drivers were independent contractors. The court concluded that the operating agreement signed by the drivers established an intent to create an independent contractor relationship. And it also focused on FedEx's lack of control over the drivers and found the following factors persuasive: drivers were able to hire helpers and replacements, acquire vehicles and use them for other commercial purposes, and sell routes to other qualified drivers.

In March 2010 in Pennsylvania, two subsidiaries of [Snyder's of Hanover](#) entered into a \$10 million class-action settlement with more than 1,500 delivery drivers who were allegedly misclassified as independent contractors. The drivers argued that they were owed back pay, overtime, holidays, meals, break and rest periods, employment benefits, contributions to retirement plans and compensation for work related expenses. The court never decided whether the workers were full employees--before that could happen, the two Snyder's subsidiaries made a business decision to settle the lawsuit.

### REGULATION FOLLOWS

The federal government and numerous state legislatures are also taking notice. Next year, the [United States Department of Labor \(DOL\)](#) will receive a \$25 million budgetary allocation that will be used to hire hundreds of investigators and enforcement staff to identify employers that incorrectly categorize workers.

Similarly, the [Internal Revenue Service \(IRS\)](#) has begun auditing roughly 6,000 companies to enforce penalties for improper classification. Both houses of Congress are also considering adoption of the [Employee Misclassification Prevention Act](#), which would require employers to keep records of the wages and hours of independent contractors. The legislation also requires employers to notify workers of their status and advise them that they may contact the DOL if they believe they have been misclassified.

Even at the state level, enforcement is ramping up. In July 2010, FedEx entered into a \$3 million settlement with the state of Massachusetts for violations of the Massachusetts Independent Contractor Law. In addition to Massachusetts, many other states are enacting laws addressing misclassification including: New York (through executive order), Connecticut, New Mexico, Maine, Vermont, Washington, Nebraska, and many others.

### AVOIDING MISSTEPS

Inaction on the issue of worker misclassification is not an option. Employers can take the following steps to protect themselves.

Conduct internal audits. An internal audit is used to verify the status of workers by examining employment records, expense lines and invoices and then comparing these records with the IRS guidelines or state law definitions of an employee. Outside counsel or internal auditors can be hired to manage these audits. They may be better placed to understand the complicated legal classification landscape.

Also, have classification issues handled by human resources for centralized management of classification decisions. Employment contracts can define the relationship between worker and employer--but be careful. If a worker is a "centerpiece" of the employer's business or if the employer has complete control over the hours worked and tasks performed, the independent contractor label is not appropriate.

Before drafting an employment contract, identify applicable state and federal law and classify workers according to state and federal definitions. Take note that employers are not necessarily able to choose what law will apply. In [Narayan v. EGL Inc.](#), for instance, the Ninth Circuit Court of Appeals determined in its July 2010 opinion that California law would apply to worker classification even though the workers had signed an agreement that required the employment contract to be interpreted under Texas law. The court reasoned that, because the EGL drivers did not sue under the employment contract, their employment benefits under California law would not be diminished by that contract.

While a proactive and pre-emptive examination of internal structures and workplace classifications may seem to be but another expense in already financially difficult times, careless classification can trigger greater harm and expense.

**October 1, 2010**

Copyright 2010© LRP Publications