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Misclassification of Independent Contractors and Employees Can Be Expensive

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When employers hire a work force, a fundamental preliminary decision with serious economic repercussions must be made: Are workers employees or independent contractors? The right answer is dependent on a fact-intensive inquiry that revolves around the degree of control that the employer has over the worker, as well as the applicable test, which varies under different federal and state laws.

The classification of workers implicates many significant issues, such as:

- Whether income taxes must be withheld and FICA payments made;
- Whether state law unemployment compensation or workers' compensation laws apply;
- Whether employees qualify for health and retirement benefits governed by ERISA, leave under the FMLA or analogous state laws, overtime pay under the FLSA or vacation pay under state wage payment laws; and
- Whether workers can bring claims under the myriad of federal and state anti-discrimination and other labor and employment laws.

While employers can effect great savings through classifying workers as independent contractors, employers who improperly classify employees as independent contractors face even greater liabilities in litigation brought by private parties or federal or state governmental entities, including the payment of lost wages and benefits, taxes, interest, penalties and attorney fees.

FedEx Ground Package System Inc. has been battling claims in multiple jurisdictions over its classification of drivers as independent contractors. On Oct. 15, 2007, Chief Judge Robert L. Miller of the Northern District of Indiana certified a nationwide class of more than 20,000 current and former drivers who brought suit under the Employee Retirement Income Security Act seeking benefits under several FedEx plans for which they were not eligible because they were deemed independent contractors.

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Miller also certified a class of at least 102 current package and delivery drivers and an undetermined number of former drivers who allege violations of the Kansas Wage Payment Act, as well as common law claims of rescission, unjust enrichment and quantum meruit under state law. Rulings on other class certifications for drivers nationwide claiming violations of the Fair Labor Standards Act and the Family and Medical Leave Act, as well as driver claims under 35 other state laws, are pending in this multidistrict litigation. *In re FedEx Ground Package System, Inc., Employment Practice Litigation*, Case No. 3:05-MD-527 RM (MDL-17000), 2007 WL 3027405 (N.D. Ind. 2007).

Recently, on Nov. 29, 2007, in related class action litigation, the California Supreme Court rejected FedEx's appeal of a California appeals court's affirmance of a trial court's finding that single-route drivers were employees rather than independent contractors for the purpose of their entitlement to reimbursement for work-related expenses under California Labor Code §2802(a). *Estrada v. FedEx Ground Package Sys., Inc.*, 64 Cal. Rptr.3d 327, 330 (Cal. Ct. App. 2nd Dist. 2007), aff'd 2007 Lexis 13422 (Cal. Sup. Ct. Nov. 28, 2007); see also §2802(a) (providing that "[a]n employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties.").

Notwithstanding that FedEx drivers executed a non-negotiable Pick-up and Delivery Contractor Operating Agreement, which identified the driver as an "independent contractor" and not as an "employee" for any purpose, the trial court found that the drivers were employees and therefore had the right to be reimbursed for their expenses.

Because the California Labor Code does not expressly define "employee" for purposes of §2802, the appellate court applied the common law test to determine how to classify the FedEx drivers.

Emphasizing that the essence of the test is the amount of control that the employer has over the worker, the court instructed that employers should consider:

1. Whether the worker engages in specialized work;
2. Whether the work is usually done with supervision;
3. The skill required;
4. Who supplies the equipment, tools and place of work;
5. The length of time for which the services are to be performed;
6. The method of payment, whether by hours worked or by job;
7. Whether the work is integrated into the employer's business;
8. Whether the parties believed that they were creating an employer-employee relationship; and
9. Whether the parties' actual conduct, regardless of the label given in the contractual agreement, reflected an employer-employee relationship.

Applying these factors, the appellate court concluded that there was substantial evidence to support the trial court's finding that the FedEx drivers were employees for purposes of §2802.

The court stressed that FedEx had control over "every exquisite detail" of the driver's performance, namely:

• FedEx determined the drivers' uniforms -- even the color of their socks, the style of their hair, the types of scanners and forms used and the provider of the trucks, which FedEx financed;

• The drivers worked exclusively and full time for FedEx under the immediate supervision of FedEx terminal managers;

• The drivers were paid weekly, with nominal opportunity for profit, which drivers could lose at the discretion of FedEx managers for failure to strictly comply with FedEx rules; and finally,

• FedEx provided the drivers with standard employee benefits.

The case will now be remanded to the state trial court to determine the compensation and damages to be awarded to drivers and the amount of fees to be awarded to their attorneys.

In contrast, a federal court in California recently held that employer EGL correctly classified its truck drivers as independent contractors. *Narayan v. EGL, Inc.*, No. C-05-04181 RMW, 2007 WL 2021809, at *2 (N.D. Cal. 2007). In this case, the three plaintiff truck drivers, who performed freight pick-up and delivery services for EGL, alleged that EGL misclassified them, and a class of similarly situated drivers, as "independent contractors" in order to avoid various duties and obligations owed to them under California labor codes and unfair competition laws.

In finding that the truck drivers were properly classified as independent contractors, the court emphasized that "it is control over the means and details of accomplishment, and not merely control over the end result, that could give rise to an employment relationship."

The court noted that the following facts supported its conclusion:

• The drivers owned, operated and maintained their vehicles;

• The drivers had control over how to route their deliveries;

• The drivers were paid by the job, as opposed to on an hourly or salary basis; and

• The drivers made themselves available at their own discretion.

Legal battles like *Estrada* and *Narayan* over the misclassification of workers have lead to executive and legislative responses across the country, including Indiana, Minnesota, New Hampshire, New Jersey, New York and, recently, Illinois. In Illinois, the General Assembly has passed the Employee Classification Act, effective Jan. 1, 2008, which is applicable to construction contractors. The act provides that individuals performing construction services for a contractor will be deemed to be an employee unless the contractor can show that the individual meets several stringent tests. The act provides for both civil and criminal penalties and provides for a private right of action.

FedEx's legal troubles in *Estrada* should remind employers that actions speak louder than words. Simply contracting with a worker as an independent contractor is insufficient and is not dispositive of the worker's status. Courts will ignore the contract label if it is at odds with the actual relationship. The costs of erroneous classifications are great. Employers must carefully analyze the factual reality of their relationship with workers before classifying workers as independent contractors as opposed to employees.

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