

Independent Contractor Misclassification: DOL to Expand Crackdown

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Expanding the perfect storm of regulation, legislation, and litigation, the U.S. Department of Labor (DOL) expects to release in April a draft of proposed regulations affecting businesses that retain any worker classified as an independent contractor or other nonemployee status. In addition, the DOL's recently announced budget plans for 2011-2012 target the misclassification of workers as independent contractors. This comes on the heels of similar federal and state legislative initiatives and ongoing litigation.

Why the storm? It's largely about tax revenues. State and federal tax shortfalls are estimated in the billions of dollars owing to the improper classification of workers as independent contractors vs. employees. The alleged misclassification is said to result in massive uncollected employment-related taxes, including contributions to state unemployment benefit funds.

Regulators and legislators also say they want to "level the playing field" for businesses that properly pay employment-related taxes and are at a competitive disadvantage compared with the tax cheats. Hence, one proposed federal bill is titled the Fair Playing Field Act of 2010 (H.R. 6128, S. 3786), which, although not enacted in the last Congress, is expected to be reintroduced in March.

This perfect storm appears destined to continue for a while. Agency regulations and enforcement activities will expand. More legislation by state and federal legislatures is expected. And litigation brought by private plaintiffs will continue. Accordingly, businesses must watch for these developments and monitor internal compliance efforts.

US-DOL Announces Latest Plans for New Regulations and Budget Targets

The Wage and Hour Division of the US-DOL administers and enforces the Fair Labor Standards Act, 29 U.S.C. § 201, *et seq.*, among other laws. Officials at the Division have been saying publicly for almost a year that they want new regulations, which will require employers to keep certain records related to any person who is hired in a nonemployee status (*e.g.*, independent contractor, unpaid intern, etc.) and who is thus treated as not covered by the wage and hour laws. This is part of what the DOL calls its "misclassification initiative."

"Right To Know" Regulations Coming Soon from DOL

The draft regulations are expected to be published in April. In the DOL's latest published Regulatory Agenda issued in December 2010, the item on this subject is titled: "Right To Know under the Fair La-

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bor Standards Act.” The DOL’s published summary describes two elements of a right-to-know rule:

The Department of Labor proposes to update the recordkeeping regulations under the Fair Labor Standards Act in order to enhance the transparency and disclosure to workers [1] of their status as the employer’s employee or some other status, such as an independent contractor, and [2] if an employee, how their pay is calculated.

In webchats and other communications earlier in 2010, the Wage and Hour Division indicated that the new recordkeeping regulations will require companies to provide written information to an independent contractor explaining that the company considers the person not to be covered by the wage and hour laws. The Division also indicated that companies might be required to conduct written “classification analyses,” evaluating why certain individuals are classified as not covered by the law. A company’s classification analysis would be provided to the person and would be available to government investigators.

Despite much public concern that the so-called “classification analysis” might be required not just for every person treated as an independent contractor but also for every employee treated as exempt from overtime pay (a potentially-massive undertaking for employers), Division officials have been evasive on this question during public webchats. Thus, it remains to be seen what type of “classification analysis” might be required and whether such a written analysis will be required only with regard to independent contractors.

The draft regulations expected in April will not take effect immediately. Instead, there will be a public comment period so that interested parties can submit written comments to be considered before the proposed regulations are revised and issued as final regulations.

DOL’s Proposed Budget Plans Target Misclassification

In its recently published Budget In Brief, the DOL describes plans for multi-agency action on the issue of misclassification of workers as independent contractors. For fiscal year 2012, the Department intends to expend substantially more money and more staff resources on this initiative.

For example, the budget document describes federal/state cooperative efforts on this initiative stating that the Department will redouble its efforts to *combat worker misclassification* by investing \$46 million for a multi-agency initiative of the Office of Federal Contract Compliance Programs (OFCCP), the Wage and Hour Division, OSHA, the Office of the Solicitor, and the Employment and Training Administration, which will fund state grants that address worker misclassification within the context of the unemployment insurance program. The DOL says this initiative will help level the playing field for employers who abide by the law and provide employees with their rightful pay and benefits.

The DOL is also working increasingly with the IRS and the states on this initiative. The budget document describes goals for additional investigators and investigations and action on targeted industries. The DOL states that the budget includes a new multi-agency *Misclassification Initiative* that will strengthen and coordinate Federal and State efforts to deal with labor violations that result from the misclassification of employees as “independent contractors” and to deter such violations in the future. For the Wage and Hour Division, the request of \$15,223,000 will support field investigator training activities and an additional 3,250 investigations. These investigations will be directed to industries that have higher rates of violations, such as construction, child care, home health care, grocery stores, janitorial, business services, poultry and meat processing, and landscaping.

Federal and State Legislators Join the Action

On the legislative front, Congress and the states remain interested in targeting the misclassification of independent contractors. In the 2010 Congress, both the Fair Playing Field Act (H.R. 6128, S. 3786) and the Employee Misclassification Prevention Act (H.R. 5107, S. 3254) were introduced, though not acted upon. Both bills are expected to be reintroduced.

The Fair Playing Field Act is a tax measure which would end a “safe harbor” in the tax code that generally permits an employer to treat a worker as an independent contractor for employment tax purposes if the employer has a reasonable basis for such treatment and is consistent in its completion of tax returns for the worker. Under the bill, anyone who contracts on a regular and ongoing basis with independent contractors would be required to provide a written statement to each independent contractor regarding the federal tax obligations of contractors, the labor and employment protections that do not apply to independent contractors, and the right of the independent contractor to seek a status determination from the IRS.

In September, Vice President Joe Biden said he believes such legislation should be a priority. The White House fiscal year 2011 budget included a proposal to curb worker misclassification, and the Joint Committee on Taxation estimated that it would increase federal revenues by \$6.9 billion over 10 years.

The Employee Misclassification Prevention Act would amend the Fair Labor Standards Act and has strong support from the DOL. The bill would make independent contractor misclassification an FLSA violation, require employers to provide workers with notice of their classification as employees or nonemployees, and authorize the recovery of civil monetary penalties for violations of recordkeeping requirements. The bill would also create a legal presumption that a worker is an employee if the em-

ployer has not met recordkeeping and worker-notice requirements. That presumption could be rebutted only by clear and convincing evidence.

In some states, similar legislation has already been enacted. For example, in New York last summer, the legislature and governor enacted a law targeting the construction industry. The law creates a legal presumption that all construction workers are employees unless certain criteria are met. The law also requires that companies give workers a notification of their classification status.

Similarly, in Pennsylvania, a new law titled the Construction Workplace Misclassification Act took effect in February 2011. The law makes it a criminal offense for a contractor to knowingly misclassify an employee as an independent contractor. The law establishes rigid criteria for differentiating an independent contractor from an employee in the construction industry.

Litigation Continues, But Some Results Are Favorable for Employers

Despite all the pressures being applied to target possible misclassification of independent contractors, some recent favorable court rulings for employers indicate that all is not lost for employers who are challenged. In a significant victory for FedEx Ground Package System, Inc. in December, the federal district court for the Southern District of Indiana ruled that 20 of 28 class action suits consolidated in a multi-district case involving drivers should be dismissed because the drivers were independent contractors in wage-related suits under the laws of the states involved. *In re FedEx Ground Package System Inc. Employment Practices Litigation*, 2010 BL 298223 (N.D. Ind. 2010).

A similar victory occurred for FedEx Home Delivery in 2009 when the National Labor Relations Board sought to treat the company's drivers as employees for union-election purposes, but the D.C. Circuit Court of Appeals reversed and found the drivers to

be independent contractors. *FedEx Home Delivery v. NLRB*, 2009 BL 85113 (D.C. Cir. 2009).

In August of 2010, in a case involving Principal Financial Group, the Ninth Circuit found that a “career agent” who sold financial products was an independent contractor, not an employee, under Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e, *et seq.*, and could not sue for sex discrimination. *Murray v. Principal Financial Group*, 2010 BL 171019 (9th Cir. 7/27/10).

In summary, although the storm forces continue to blow and employers must exercise caution, both a business and legal case can sometimes be made for the treatment of certain workers as independent contractors. Nevertheless, if the circumstances present a close case for claiming independent contractor status, businesses must expect heavy scrutiny from regulators, legislators, and litigators.

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