Misclassification of Independent Contractors: A Non-Compete Issue?

Insights
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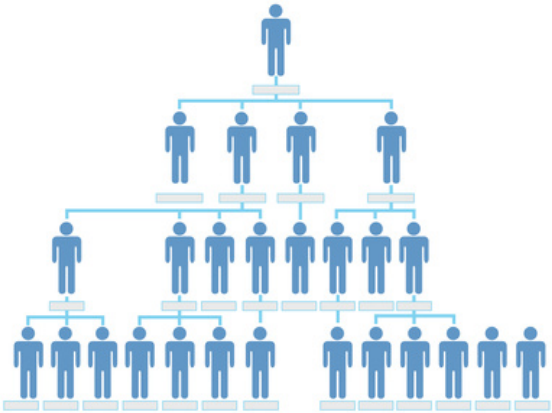

Much has been written about misclassification of employees as independent contractors. Discussion often focuses on the economic consequences of misclassification, such as the IRS concluding that it has been deprived of revenue. For instance, the Small Business Administration says that proper classification matters because it "affects how you withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment taxes." In a recent decision, a panel of judges from the United States Court of Appeals for the 3rd Circuit found one more reason it matters: companies may not be able to enforce restrictive covenants against individuals misclassified as independent contractors.

In Figeuroa v. Precision Surgical, Inc., the 3rd Circuit Panel upheld a district court decision denying a preliminary injunction. The district court declined to issue a preliminary injunction enforcing a restrictive covenant because it found that Precision Surgical had breached its Independent Contractor Agreement ("ICA") with Figueroa by treating him as an employee, instead of "according him the flexibility to be accorded an independent contractor."

Caveats? Well, a few things should be kept in mind. First, the appellate court's decision slapped a big, bold, all-capped label on the top of its opinion that says: "**NOT PRECEDENTIAL**." (A copy of the Court's opinion is available in pdf format below.) Second, a reading of the 3rd Circuit Panel's opinion makes clear there was no way Precision Surgical was going to prevail on appeal. The Panel upheld the lower court's decision not just on employee misclassification grounds, but also based on a finding that Precision Surgical failed to pay Figueroa commissions, failed to demonstrate irreparable harm, and failed to offer any consideration in support of the ICA. All of these factors

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were discussed with heavy admonitions that the lower court's decision would not be disturbed absent an abuse of discretion.

So what's the takeaway on this case? Two points: First, although this decision was labeled "NOT PRECEDENTIAL," employee classification can affect enforceability of a restrictive covenant. Now employers have one more incentive to ensure they have properly classified their independent contractors. Vulnerability on restrictive covenants may leave a company vulnerable to poaching by competitors. Second, preliminary injunctions are hard to obtain in district court, but they are even harder to obtain on appeal. Stated differently, the grant or denial of a preliminary injunction – an equitable remedy – is heavily dependent upon judicial discretion. Judges are human beings, and like anyone else, they are going to have individual reactions to the facts that are presented to them. If you factor equitable discretion into the mix, it is possible (if not likely) that two different judges could view the exact same case differently. If you place an appellate abuse of discretion standard on top of that, the odds of success on appeal can be daunting.

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