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United States: Worker Misclassification – The Next Big Legal Concern?

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Clients frequently ask their counsel: What is the next legal issue that should concern me because of its effect on the way my company operates? The answer to that question, and it could soon become a very big issue.

On June 9, 2007, in an article published in the *New York Times* by Steven Greenhouse, New York Governor Eliot Spitzer announced that he would sue companies that illegally misclassify workers as independent contractors" rather than employees. The focus on this issue is not a growing "worker misclassification" movement. Federal and state agencies are auditing, examining and/or litigating against companies whose classification of workers as independent contractors is erroneous. The scrutiny on the classification issue has even reached the highest levels of government.

On May, 8, 2007, the House Committee on Ways and Means held a hearing on the effects of misclassifying workers as independent contractors. The hearing was held from the Government Accountability Office that noted the Department of Labor (DOL) is failing to track the instances in which workers are misclassified and is missing opportunities to address other instances of potential misclassification. Part of the solution to the misclassification problem is to increase oversight responsibilities by DOL. The increased focus on misclassification by federal and state agencies should be a concern for all employers in their workforce.

Attacks on the Contractor Model

Attacks on the contractor model (*i.e.*, the reliance on an independent workforce to conduct business) focus on indicia of contractor performance of his or her services. Independent contractors are supposed to be skilled individuals who perform services for a client on a contract basis and means in which their services are performed. Employees, on the other hand, often lack specific skills and are

told specifically how their work is to be performed (including the hours, pace, place and nature of their work). Problems arise when the contractor model is used in a relationship which is generally acceptable in a contractual relationship, and "control" over the manner and means of performance, which is a characteristic of an employment relationship, their contractual relationships become susceptible to attack. In recent years, the contractor model has been attacked by

- The National Labor Relations Board;
- State agencies that administer workers compensation or unemployment compensation;
- The Internal Revenue Service;
- Disgruntled contractors;
- Plaintiffs' lawyers; and
- Labor unions.

These agencies, groups and individuals are attacking the contractual relationship and seeking reclassification of contractors as employees by exerting control over:

- Contractors' time and schedule (*i.e.*, the time contractors start their work day, finish their work day, take their lunch and

- The person(s) or client(s) with whom contractors will be working or are allowed to use to assist the contractors in the
- Contractors' methods for performing their work (*i.e.*, how the contractor will service a client or complete a task).

In addition to identifying issues of control over the manner and means of performance, attacks on the contractor model focus familiarization), work solely for one company, have incorporated their businesses, supply their own tools or equipment, wear a relationship or can be terminated at will, and/or have an opportunity to increase their profits or incur losses. Depending on the agency or a court may conclude that an employer-employee rather than an independent contractor relationship exists.

Companies' Increased Exposure

Misclassifying workers leaves companies exposed to increased government scrutiny, significant liability and a reduction in profit attacks on the contractor model increase companies' exposure by making them susceptible to:

- Claims for back taxes such as federal payroll taxes (*i.e.*, social security and Medicare) and state taxes;
- Claims for back benefits (like health insurance) that the previously classified contractor paid himself or herself;
- Claims for back pension contribution or profit sharing that the previously classified contractor did not receive;
- Potential large fines from federal and state agencies;
- Increased tort liability under the theory of respondeat superior (a legal doctrine holding employers responsible for the to independent contractors;
- Increased liability arising from suits alleging intentional misclassification in which punitive or treble damages are available
- Increased or new organizational efforts from unions.

The result of this increased exposure is a loss of the competitive advantage gained from using an independent workforce if companies will have higher fixed costs which translates into lower profits). The increased exposure and potential reclassification also would (capital) to address problems associated with the misclassification rather than growing the business.

Attacks on Contractor Model Have Staying Power

The misclassification issue is here to stay, and attacks on the contractor model will likely continue to increase for one reason: awards attracts those who attack the contractor model, including government agencies, disgruntled contractors, plaintiff attorneys reasons.

First, as the *Times* article notes, federal and state governments are attracted to this issue because they are losing hundreds of erroneous classification of workers. Federal and state governments' tax, treasury and labor departments are deploying significant strategies to collect the taxes to which they believe they would have been entitled but for the misclassification. State governments clarify the definition of employee and independent contractor.

Second, disgruntled contractors are looking to profit from classification challenges. These contractors, if reclassified as employees lost overtime pay and the expenses of providing their own benefits (like insurance) and even retirement contributions or lost as contractor's employee counterpart. Throw punitive damages into the mix and the contractor has significant reason to challenge

Third, the plaintiffs' lawyer also sees worker classification as a potential source for a pay day. Because the contractor model is perform the same function, challenges to classification usually involve a group of workers who were similarly classified. The plaintiff class action, hoping to recover substantial attorney fees.

Finally, labor unions also see an opportunity in the classification issue to organize and obtain new members. Increased membership unions sometimes work hand-in-hand with the plaintiffs' lawyer to find the best client(s) to challenge the models.

In light of the significant opportunity for monetary gains for federal and state governments, employees, plaintiffs' lawyers and continue to increase.

Potentially Vulnerable Business Sectors

Many industries are potential targets for claims of worker misclassification. As the *Times* article noted, Governor Spitzer previc that construction and package delivery companies are susceptible to classification challenges based on those industries' heavy involved in a high-profile challenge to its worker classification. Defense companies could face similar challenges given their uti could face challenges given their reliance on contractors to conduct product installation or repairs; multi-level marketing agen of

contractors to sell products; and the list goes on. Simply put, worker misclassification cuts across industries affecting any com

Perhaps the type of business most vulnerable to the misclassification challenge, however, is a financial services company. Finz have regulatory responsibilities that require control over the behavior of their broker-dealers and registered representatives, w the day-to-day manner and means of the performance of their brokers and registered representatives notwithstanding their cl the regulations do not even distinguish employees from contractors. Websites exist, like <http://www.armydiller.com/financial-> and registered representative relationship as one steeped in fraud. These same sites solicit workers to join the fight against fir may lead to cases similar to the recent case of *Havel v. Sun America Securities Inc.*, 2006 WL 2917591 (N.D. Cal), in which th contractors is being challenged.

Remedial Steps

Worker classification is a multifaceted issue that requires a multifaceted legal response. The issue implicates tax and labor law sector, the issue also requires the necessary regulatory background. Sutherland Asbill & Brennan's legal team not only posses address this dynamic issue, but also has been closely monitoring the trends in this arena and is experienced in identifying the more important, Sutherland has worked with clients to find creative solutions to stymie attacks on their contractor model and protect them from pending, potential or future attacks. Defending the contractor model is not impossible (or even difficult for places companies in the best position to defend their contractor model when challenges do arise. In this area, an ounce of pre

Please feel free to contact the Sutherland attorney with whom you usually work or any of the attorneys listed below if you ha

Lisa Combs Jern. Allegra J. Lawrence-Hardy, Richard G. Murphy Jr., Alice Murtos and

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