

Worker Classification: An Independent Contractor Update

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Introduction

- **Summary of Various Worker Classification Tests**
- **Overview of Recent Significant Court Decisions**
- **Wage & Hour's Administrator's Interpretation**
- **Motor Carrier Employer Amnesty Program of California**
- **Practical Considerations**

Various Worker Classification Tests

- **The Common Law “Right of Control” Test**
 - The common law test is still widely used.
 - Courts examine various factors to determine whether an alleged employer has exercised enough control over an individual to classify the relationship as employer-employee.
 - The right of control test is highly factually specific.

Worker Classification Tests (Cont'd)

Common Law Right of Control Test . . .

- The test does not require an employer to actually exercise control, it only requires that an employer could exercise control over the individual if the employer chose to do so.
- And, courts have developed factually specific factors to guide the determination as to whether an alleged employer could exercise control over an individual.

Worker Classification Tests (Cont'd)

Common Law Right of Control Test . . .

The factors include:

- Control of the means and methods of the work
- Provision of necessary equipment
- Performance of tasks without supervision
- Possession of required permits/licenses
- Determination of the hours of work

Worker Classification Tests (continued)

■ **Modified Control Standard**

- Indicia of Control vs. Indicia of Autonomy
- Essentially the IRS Test
- 20 factors grouped into three broad categories analyzing:
 - Behavior Control
 - Financial Control
 - Relationship of the Parties

Worker Classification Tests (continued)

■ **Economic Realities Test**

- Developed by the U.S. Supreme Court in 1974.
- Used by the U.S. Department of Labor and the Social Security Administration
- Focuses on whether a worker is dependent on the employer or is in business for him or herself.

Worker Classification Tests (continued)

- The “Economic Realities” test factors include:
 - the extent to which the work performed is an integral part of the employer's business;
 - the worker's opportunity for profit or loss depending on his or her managerial skill;

Worker Classification Tests (continued)

- the extent of the relative investments of the employer and the worker;
- whether the work performed requires special skills and initiative;
- the permanency of the relationship; and
- the degree of control exercised or retained by the employer.

Worker Classification Tests (continued)

■ “ABC” Test

- Several states use the predominant “ABC” test to determine worker classification.
- Each prong of the “ABC” test must be satisfied to conclude worker is an employee.

Worker Classification Tests (continued)

The prongs are:

- a) The worker is free from control or direction in the performance of the work;
- b) The work is done outside the usual course of the company's business or is done off the premises of the business;
and
- c) The worker is customarily engaged in an independent trade, occupation, profession, or business.

Worker Classification Tests (continued)

■ Modified “ABC” Test

The modified “ABC” test presumes an employment relationship, unless the employer can demonstrate that:

- a) The individual is free from control and direction in connection with the performance of service (both under the contract and in fact);
- b) The service is performed outside the usual course of the business of the entity; and
- c) The individual is customarily engaged in an independently established trade, occupation, profession or business.

Worker Classification Tests (continued)

Under the more restrictive prong “B,” an employer can only escape the “employer/employee relationship” by showing that the “service is performed outside of the usual course of business.”

Recent Noteworthy Court Decisions

- ***W. Logistics, Inc. v. Indus. Claim Appeals Office*, 2014 CO 31, 2014 Colo. LEXIS 352 (Colo. 2014)**
 - Court considered worker classification for unemployment tax liability purposes under the Colorado Employment Security Act.
 - The determination was based on whether the alleged employer could provide that the individual was:
 1. Free from control and direction in the performance of services, and
 2. Customarily engaged in an independent trade or business related to the services performed.

Recent Noteworthy Court Decisions (cont'd)

The Court concluded that “[w]hether an individual is customarily engaged in an independent trade or business related to the service performed is a question of fact that can only be resolved by applying a totality of circumstances that evaluates the dynamics of the relationship between the putative employee and employer; there is no dispositive single factor or set of factors.”

Recent Noteworthy Court Decisions (cont'd)

- ***Moba v. Total Transp. Servs.*, 2014 U.S. Dist. LEXIS 58854 (W.D. Wash. Apr. 25, 2014)**
 - A group of owner-operators alleged violations of the Fair Labor Standards Act (FLSA) and Washington Law Against Discrimination Act (WLAD), by Seattle Freight Services, Inc. (Seattle Freight).
 - The threshold question was whether the owner-operators were employees or independent contractors, as neither the FLSA nor WLAD apply to independent contractors.

Recent Noteworthy Court Decisions (cont'd)

- The court applied the “economic realities” test adopted by the Ninth Circuit Court of Appeals.
- In the opinion, the Court fairly quickly dispatched with the “right to control” and “degree of permanence” factors of the “economic realities” test.
- Of particular note is the way the court addressed the issue regarding whether the owner-operators were an integral part of the motor carrier’s business.

Recent Noteworthy Court Decisions (cont'd)

- In making its determination, the court relied on a decision out the Eastern District of New York, and focused on factors, such as:
 - the driver's freedom to make his own schedule,
 - the ability to work for other companies,
 - the discretion to decline offers of dispatch, and
 - whether the driver owns, insures, maintains and services his vehicle without reimbursement or contribution from the motor carrier.

Recent Noteworthy Court Decisions (cont'd)

- Using those factors, the court determined that the owner-operators were ultimately in business for themselves, suggesting independent contractor status.
- The court held that “[w]hether one is an employee for purposes of the FLSA depends on the totality of the circumstances and whether, as a matter of economic reality, the individual is dependent on the business he or she is serving. **Neither the presence nor the absence of any individual factor is determinative.**”

Recent Noteworthy Court Decisions (cont'd)

- The takeaway from the W. Logistics and Moba decisions is that some courts show a propensity to look at the broader picture in worker misclassification disputes.
- Motor carriers should argue that a broader-based test should apply when faced with “check-the-box” “ABC” type statutory tests.
- The totality of the circumstances evaluates the big picture and more fairly and accurately demonstrates the business reality of the relationship between an owner-operator and motor carrier.

Recent Noteworthy Court Decisions (cont'd)

***Mass. Delivery Ass'n v. Coakley*, 769 F.3d 11 (1st Cir., 2014)**

- The Massachusetts Delivery Association (MDA) brought suit against the Massachusetts Attorney General in 2010, claiming that Prong B of the Massachusetts “ABC” test is preempted for motor carriers under the Federal Aviation and Administration Authorization Act of 1994 (FAAAA).
- MDA argued that under Massachusetts law a courier member company must consider its independent contractor drivers as employees.

Recent Noteworthy Court Decisions (cont'd)

- Since the delivery services performed by the independent contractor drivers are done in the usual course of business for delivery companies, they could never pass “Prong B” of the test
- The result would affect prices charges, routes used, and services offered to customers by delivery companies, in contravention of FAAAA, because the companies would have to severely alter business models to comply.
- The District court found no FAAAA preemption. MDA appealed.

Recent Noteworthy Court Decisions (cont'd)

- The First Circuit reversed and sent the matter back to the District Court for further consideration as to whether the Massachusetts statute satisfies the broad federal preemption test.
- Generally, FAAAA says that states cannot enact or enforce laws that are related to “a price, route, or service” of any motor carrier with respect to the “transportation of property.”

Recent Noteworthy Court Decisions (cont'd)

- In effect, the First Circuit held that a statute's "potential" impact on motor carriers' prices, routes and service can be sufficient if it is significant, rather than tenuous, remote or peripheral, and that courts should look to the logical effect that a particular scheme has on the delivery of services or the setting of rates, even indirectly.
- Moreover, the Court of Appeals determined that a strict interpretation of the phrase "with respect to the transportation of property" would nullify the expansive reading of relation to a "price, route, or service," effectively guaranteeing that state laws that met such criteria, albeit in a significant but indirect way, would never be preempted.

Recent Noteworthy Court Decisions (cont'd)

- After the First Circuit's decision in the MDA case:
 - On remand, District Judge Denise Casper granted summary judgment in favor of MDA, declaring that a portion of the Massachusetts independent contractor statute, particularly, Prong B, *is preempted* by FAAAA, because it affects the courier's services, routes, and prices.
 - District of Massachusetts Judge Robert Stearns granted summary judgment in favor of FedEx Ground in *Schwann, et al. v. FedEx Ground Package System, Inc.*, 2015 U.S. Dist. LEXIS 13826 (D.Mass. Feb. 5, 2015) and dismissed a complaint against J.B. Hunt in *Remington, et al. v. J.B. Hunt Transport, Inc.*, 2015 U.S. Dist. LEXIS 13825 (D.Mass. Feb. 5, 2015).

Recent Noteworthy Court Decisions (cont'd)

Judge Stearns' decisions found that FAAAA preempted Prong B of the Massachusetts "ABC" Test because the application of the test would "unquestionably have an impact on 'price, route[s], [and] services'" by effectively "proscribing the carrier's preferred business model."

In addition, since the statute was enacted in the conjunctive (meaning each prong has to be satisfied to classify a worker as an independent contractor), Prong B could not be "severed" from the statute as a whole. As a result, Judge Stearns ruled that the entire statute must be treated as preempted under FAAAA.

Recent Noteworthy Court Decisions (cont'd)

- ***Schwann, et al. v. FedEx Ground Package System, Inc. (Revisited)***
 - In February, the First Circuit Court of Appeals issued a decision affirming, in part, and reversing, in part, Judge Stearns' decision.
 - The First Circuit agreed with Judge Stearns that Prong B was preempted by FAAAA.
 - BUT, the court declined to adopt an industry-friendly bright line and, instead, reeled back the language in Judge Stearns' decision, stating that “[e]xactly where the boundary lies between permissible and impermissible state regulation *is not entirely clear.*”

Recent Noteworthy Court Decisions (cont'd)

- The court limited its holding too, ruling that Prong B was preempted only as “*Plaintiffs propose to apply it.*”
- The First Circuit also engaged in some legislative and judicial gymnastics.
- Reversing Judge Stearns’ decision that Prong A and Prong C were also preempted because those prongs could not be severed from Prong B, the First Circuit
 - Noted a judicial preference for severability; and
 - Relied on a Massachusetts legislative escape clause that “the provision of any statute shall be deemed severable.”

Recent Noteworthy Court Decisions (cont'd)

- So, despite the fact that the statute was enacted in the conjunctive, the First Circuit held that Prong B could easily be eliminated from the statute, while “leaving the remainder intact.”
- The court wrote: “We therefore *think* that the legislature’s plain aim in enacting this statute favors two-thirds of this load over no load at all as applied to motor carriers with respect to the transportation of property.” (emphasis added)

Recent Noteworthy Court Decisions (cont'd)

- ***Atiapo v. Goree Logistics, Inc.*, 770 S.E.2d 684 (N.C. Ct. App. 2015)**
 - A broker, Owen Thomas, Inc., enters into a typical broker-carrier agreement with Goree Logistics, a federally licensed motor carrier.
 - Atiapo, an independent contractor signed on with Goree Logistics, was injured in an accident while hauling a load of rejected goods brokered to Goree by Owen Thomas.
 - At the time of the accident, Goree did not have workers' compensation insurance.

Recent Noteworthy Court Decisions (cont'd)

- Atiapo filed a claim for workers' compensation, which Goree denied, since Atiapo was an independent contractor.
- The industrial commission added Owen Thomas, *the broker*, as a party, and imposed liability on Owen Thomas as a “principal contractor” under the North Carolina Workers' Compensation Act (the “Act”).
- Owen Thomas appealed, arguing that the Industrial Commission lacked jurisdiction because Owen Thomas was a freight broker, not a principal contractor, and that Owen Thomas was exempt from the Act under FAAAA.

Recent Noteworthy Court Decisions (cont'd)

- The court rejected Owen Thomas's first argument, holding that the use of the word broker was "a distinction without a difference."
 - Since Owen Thomas was a principal contractor under the Act, Owen Thomas "employed" Goree as a subcontractor without workers' compensation insurance, establishing liability under the Act.

Recent Noteworthy Court Decisions (cont'd)

- The court also rejected Owen Thomas’s FAAAA preemption argument for two reasons.
 - First, on the grounds that the Act did not regulate prices, routes, or services, and, that state regulations related to minimum insurance requirements were excepted under FAAAA.
 - Second, even though the insurance exception applied only to motor carriers, *and not brokers*, the Court held that Owen Thomas “went beyond its role as a broker” and “was, in effect, a motor carrier, despite the fact that the company itself owned no vehicles.”

Recent Noteworthy Court Decisions (cont'd)

- **Why is the *Atiapo* case important?**
 - For motor carriers utilizing an independent contractor/owner-operator business model, the language used by the Industrial Commission and the Court of Appeals strongly suggests preconceived misconceptions about the transportation industry, on the one hand, and an unfriendly business environment, on the other.

Recent Noteworthy Court Decisions (cont'd)

- If you operate a separate brokerage business, diligently follow prudent motor carrier selection protocols that ensure compliance with the duties and obligations contained within your broker-carrier agreements.

Recent Noteworthy Court Decisions (cont'd)

- If your broker-carrier agreement requires motor carriers to maintain certain insurances, it is a best practice to make certain the motor carriers with which you transact business have the coverages required under the agreement. If Owen Thomas had made certain that Goree had workers' compensation insurance, which was required under the broker-carrier contract, in all likelihood, Owen Thomas would not have been involved in the case.

Recent Noteworthy Court Decisions (cont'd)

- On February 29, 2016, the United States Supreme Court declined to accept this case for review
- Disappointingly, this means the wrongly decided *Atiapo* decision will stand

Recent Noteworthy Court Decisions (cont'd)

- ***Max Trucking, LLC v. Liberty Mutual Insurance Company*, 802 F.3d 793 (6th Cir. 2015)**
 - Max Trucking is a motor carrier transporting dry goods and general freight utilizing a fleet of independent contractor/owner-operator drivers located throughout the United States
 - Max Trucking filed suit against Liberty Mutual seeking an order that it did not owe workers compensation premiums to Liberty Mutual because its drivers were independent contractors, not employees, under the Michigan Worker's Disability Compensation Act (the "Act")

Recent Noteworthy Court Decisions (cont'd)

- Under the Act, Max Trucking purchased worker's compensation insurance coverage from Liberty Mutual through an "involuntary market" beginning in 2006
- The policy was renewed several times over a period of years
- In 2011, Liberty Mutual audited Max Trucking and determined that its Michigan-based drivers were employees, not independent contractors, under the Act
- As a result, Liberty Mutual increased the policy premium

Recent Noteworthy Court Decisions (cont'd)

- A bit of history:
 - Max Trucking converted to an owner-operator based operation after a bad accident in 2006 that resulted in a high worker's compensation expense
 - However, many owner-operator drivers lost their trucks during the economic downturn in 2008
 - So, Max Trucking developed a program in which Max Trucking purchased trucks and offered them to drivers on a lease-to-buy basis.

Recent Noteworthy Court Decisions (cont'd)

■ The Good

- Max Trucking did some pretty good things operationally
- If a driver sold his leased truck, Max Trucking paid any equity to the driver
- Max Trucking's owner-operators were able to accept or reject dispatched loads
- Max Trucking's lease-to-buy program demonstrated portability and sound finance lease accounting

Recent Noteworthy Court Decisions (cont'd)

■ The Bad

- *Max Trucking* entered into the written contracts with the drivers participating in the lease-to-buy program, meaning it was the Lessor
- *Max Trucking* held title to the trucks
- It can be difficult to parse the economic realities in cases like these
- If the motor carrier is the lessor, it is not a stretch to conclude that the driver is “economically dependent” upon the motor carrier and, thus, more like an employee
- It suggests the driver could not obtain equipment elsewhere due to credit or other issues
- The better practice is to have the equipment leased by an entity other than the motor carrier

Recent Noteworthy Court Decisions (cont'd)

■ The Ugly

- The Court.
- It is very important, even though it can be very difficult, to educate the court regarding the nuances of the trucking industry
- The Court's opinion represents another example of a court that either doesn't understand, or worse, ignores, the distinctions between trucking and other industries when looking at the employee-independent contractor distinction

Recent Noteworthy Court Decisions (cont'd)

- In this case the Court applied a 3-part test:
 - To be considered an employee, a person must show that he or she (1) does not maintain a separate business; (2) does not hold himself or herself out to render services to the public; and (3) is not an employer subject to the Act
- The District Court concluded that none of the drivers maintained a separate business; none of the drivers held themselves out to the public as a trucking business; or qualified as an employer under the Act

Recent Noteworthy Court Decisions (cont'd)

– Specifically,

- The Court made a big deal about the fact that only one driver had actually ever driven for another company;
- The Court noted the fact that the drivers used Max Trucking's DOT number exclusively; and
- The Court declined to look at any additional factors and, instead, rigidly applied the Michigan 3-part test.

Recent Noteworthy Court Decisions (cont'd)

- ***Godfrey v. Oakland Port Services Corp.*, 230 Cal.App.4th 1267 (2014), cert. denied (Oct. 28, 2015)**
 - The U.S. Supreme Court declined to review this California Court of Appeals decision that FAAAA does not preempt the claims of truck drivers for overtime, meal, and rest breaks
 - This is a dream conclusion for the class action Plaintiff's bar in California
 - No real detail, other than the Court's view of FAAAA preemption was, not surprisingly, very narrow

Recent Noteworthy Court Decisions (cont'd)

- The Court acknowledged that California law regulates wages, hours, and working conditions in the transportation industry, but did not refer at all to prices, routes, or services
- The Court entirely ignored what the First Circuit did in MDA and failed to focus at all on the indirect effects of regulation on the prices, routes, and services of motor carriers
- As I predicted when the Supreme Court declined to review this case, it likely meant that the *Atiapo* case would not be reviewed either

Wage & Hour's Administrator's Interpretation

- Issued on July 15, 2015 by David Weil, Administrator of the Department of Labor's Wage & Hour Division.
- Not a positive event, but not unexpected.
- Under the current administration, the DOL has increased funding to states for misclassification investigations, and entered into memoranda of understanding with various states and the Internal Revenue Service as part of a Misclassification Initiative.
- Notably, House and Senate appropriations committees voted last summer to discontinue funding of the DOL's Misclassification Initiative.

Administrator's Interpretation (cont'd)

- Keep the Administrator's memo in perspective – it merely provides guidance for worker classifications under the Fair Labor Standards Act (FLSA), which chiefly governs minimum wage, overtime, and child labor laws.
- The memo provides that the under the FLSA, the broad "economic realities" test, rather than the "control" test, should be applied to determine whether a worker is an employee or an independent contractor.
- The Administrator explains that the "economic realities" test focuses on whether a worker is "economically dependent" on an employer or is in business for himself or herself: "If the worker is economically dependent on the employer, then the worker is an employee. If the worker is in business for him or herself (i.e., economically independent from the employer), then the worker is an independent contractor."

Administrator's Interpretation (cont'd)

- Predictably, the Division's analysis of the “economic realities” test factors is heavily slanted in favor of concluding that most workers are employees, and concludes that, “[i]n sum, most workers are employees under the FLSA's broad definition.”
- For the majority of mainstream trucking businesses, the memo poses no new challenge.
- At the very least, the memo calls for increased awareness of the "do's and don'ts" when operating with independent contractors/owner-operators.

Administrator's Interpretation (cont'd)

- Keep in mind that the memo is not the law, nor does it have the force of law; it is merely guidance offered by a governmental agency.
- And, the transportation industry already operates under its own guidance—the Leasing Regulations—and compliance with those regulations is not indicia of control over a worker.
- The memo is by no means a death blow to the independent contractor model, but it should serve as new motivation for intensified focus on motor carrier contracts and operational conduct.
- Despite Wage & Hour's "guidance," motor carriers can continue to be successful with the independent contractor/owner-operator model.

The Motor Carrier Employer Amnesty Program of California

- On January 1, 2016, “eligible” motor carriers performing drayage services in California could begin applying for relief under The Motor Carrier Employer Amnesty Program of California
- Provided the eligible motor carrier enters into a settlement agreement with the Labor Commission, and agrees to reclassify all drivers as employees, the carrier *may* be relieved of liability for certain statutory and civil penalties associated with the classification of its reclassified drivers as independent contractors

The Motor Carrier Employer Amnesty Program of California (cont'd)

- The devil(s) are, of course, in the details
- Seven (7) reasons why a decision to participate in this program calls for a very healthy dose of careful consideration:
 - The enacted bill was born of a partnership between the California Legislature and the California Teamsters
 - Eligibility can be a challenge; carriers must apply and be accepted into the program by the Labor Commissioner

The Motor Carrier Employer Amnesty Program of California (cont'd)

- The settlement agreement must include a vague representation providing that the carrier “*will perform any other requirements or provisions the Labor Commission and the department deem necessary to carry out the intent of [the] section, the program, or to enforce the settlement agreement.*”
- If an “eligible” carrier contracts with any workers in the future as independent contractors, the carrier has a virtually insurmountable burden, to prove “**by clear and convincing evidence**” that the workers are not employees in any administrative or judicial proceeding related to the status of those workers

The Motor Carrier Employer Amnesty Program of California (cont'd)

- The statute of limitations for a misclassification claim asserted against a carrier will be tolled from the date of the application through the date of denial, or noncompliance with the settlement agreement
- If the Commissioner commences a civil action to enforce the settlement agreement, judgment may be entered within 60 days, plus costs and attorneys' fees, and the judgment does not preclude an action to recover additional civil and/or statutory penalties
- If an application is denied, neither the application or its submission shall be treated as an admission by the motor carrier that it misclassified drivers as independent contractors, and shall not be construed as an evidentiary inference that the carrier failed to properly classify drivers as employees

Practical Considerations (IC Do's & Don'ts)

- Employees are given tasks or assignments by their employers.
- ✓ Independent contractors are offered tasks or assignments that can be accepted or refused.
- Employment agreements reference employees.
- ✓ Independent Contractor Service Agreements make no reference to employees. Be consistent.
- Employers generally control the way an employee's tasks are performed.
- ✓ Independent contractors are responsible only for the results or final product.
- Employers can prohibit employees from recruiting or hiring helpers to assist with duties.
- ✓ Independent contractors are generally free to hire other workers to assist with accepted tasks.

IC Do's & Don'ts (cont'd)

- Employees are generally "at will," and can be terminated at any time for any reason.
- ✓ Independent contractors generally have mutual termination rights by agreement.
- Employees typically do not negotiate a price for services rendered on a period basis or at all.
- ✓ Independent contractors are free to negotiate pricing for services rendered to the principal.
- Employees generally do not engage in entrepreneurial activities while serving employers.
- ✓ Independent contracts are free to seek opportunities to enhance profits and grow their businesses.

Words to Live By

“If you are going to sin, sin against God, not the bureaucracy. God will forgive you, but the bureaucracy won’t.”

- Hyman Rickover, Adm. USN

Questions?

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