AMERICAN BAR ASSOCIATION
LABOR AND EMPLOYMENT LAW SECTION

WAGE & HOUR BOOT CAMP

MISCLASSIFYING WORKERS AS INDEPENDENT CONTRACTORS

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I. SCOPE OF THE MISCLASSIFICATION PROBLEM

A. WHY IS THIS RELEVANT?

1. Lawsuits alleging improper classification of workers as independent contractors are on the rise, and employers are spending significant time and expense defending them. Litigation will continue to grow as federal and state government agencies increasingly scrutinize the independent contractor model.

2. Worker misclassification lawsuits – including individual, collective and class actions – are hitting every sector and industry, including construction, insurance, financial services, grocery and parcel delivery. If a plaintiff proves that an employer acted intentionally, treble or punitive damages can apply.

3. The recent surge in worker misclassification litigation requires that employers understand the law and its implications.

B. HOW MANY WORKERS ARE REPORTED AS INDEPENDENT CONTRACTORS?

1. In 2005, the Bureau of Labor Statistics reported that there were 10.3 million independent contractors, representing 7.4% percent of the workforce.\(^2\)

2. The pervasiveness of worker misclassification has not been fully assessed since the mid-1980s, when the IRS conducted its last comprehensive examination of misclassified workers and its impact on tax revenues. In that study, the IRS estimated that 15 percent of employers had misclassified 3.4 million workers as independent contractors in tax year 1984.\(^3\)

C. (RISING) COSTS OF MISCLASSIFYING WORKERS

1. Significant Losses in Tax Revenues
   a. The misclassification of workers as independent contractors, rather than as employees, results in significant loss of revenues to federal, state, and local tax departments, Social Security, Medicare, the unemployment insurance trust funds, and workers compensation funds.
   b. In a 2000 U.S. Department of Labor (“DOL”) study, researchers estimated that, if only one percent of all employees were misclassified across the


country, the underreporting of unemployment taxes would total roughly $200 million each year.\(^4\)

\(c.\) The Government Accountability Office (“GAO”) has estimated that worker misclassification costs the federal treasury $4.7 billion annually in income tax revenues.\(^5\) President Obama’s budget for the fiscal year 2011 further estimates that another $7 billion will be lost in payroll tax revenues over the next 10 years.\(^6\)

2. Violations of Employee Rights

\(a.\) Individuals characterized as “employees” are entitled to the benefits and protections of federal and state anti-discrimination laws, employment rights laws, unemployment insurance, and wage and hour laws, to name just a few.

\(b.\) Conversely, those who are erroneously classified as independent contractors are deprived of many, if not most, of the protections to which they would be entitled if they were properly classified as employees.

\(c.\) By and large, independent contractors fall outside the protective umbrella of anti-discrimination, employment rights, unemployment insurance and wage and hour laws.

3. Penalties for Employers

\(a.\) When an independent contractor is reclassified as an employee, an employer will likely be subject to income tax liability for monies that should have been withheld from the “wages” of the “employee,” employer’s contributions of social security and federal unemployment taxes, potential overtime pay and other wage claim liability, state unemployment insurance payments, workers’ compensation insurance premiums (and potential liability for workplace injuries), and other civil penalties and fines.

\(b.\) Further, reclassified workers may be entitled to coverage and benefits under applicable employee benefit plans.

\(c.\) State Attorney Generals may even seek criminal sanctions against business owners or executives who are found to have misclassified their workers. New York Attorney General Cuomo has led the effort in prosecuting

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businesses that misclassify their workers as independent contractors. See infra at Section VIII.C.

II. FACTORS DRIVING MISCLASSIFICATION – WHY EMPLOYERS TAKE THE RISK?

While the line between an “employee” and an “independent contractor” may be muddied at times, companies have increasingly taken the business risk to maintain the independent contractor status of workers, especially in these tough economic times. Described briefly below are some of the main factors driving the improper classification of workers. Such “incentives” for treating workers as independent contractors, instead of employees, have led to widespread mischaracterizations of independent contractors who function more as traditional employees.

A. SAVINGS ON TAXES AND BENEFITS

1. Businesses that (mis)classify workers as independent contractors do not have to pay unemployment insurance taxes, workers’ compensation premiums or the employer’s portion of Social Security and Medicare taxes – which typically equal approximately 7.65 percent of a worker’s wages.

2. Additionally, those companies do not have to pay and withhold payroll taxes that they would otherwise be required to pay and withhold under the Federal Insurance Contributions Act (“FICA”).

3. With respect to tax-qualified pension plans (such as 401(k) plans, defined contribution plans, and defined benefits plans), an employer may only maintain a tax-qualified plan for the exclusive benefit of its employees. Independent contractors are not eligible to participate in such tax-qualified pension plans. Thus, an employer can realize significant savings related to employee benefits by classifying workers as independent contractors, rather than as employees.

B. ANTI-DISCRIMINATION LAWS AND OTHER EMPLOYEE RIGHTS

1. Independent contractors are not covered by many of the labor laws that protect employees. For example, they are exempt from minimum wage and overtime protections, as well as from most discrimination and occupational safety laws. Additionally, independent contractors do not have a right to unionize. C.C. Eastern, Inc. v. NLRB, 60 F.3d 855, 857-58 (D.C. Cir. 1995) (holding that the jurisdiction of the NLRB extends only to the relationship between an employer and its “employees”; it does not encompass the relationship between a company and its “independent contractors” and therefore characterization of a group of workers as “independent contractors” is dispositive as to whether they may elect a bargaining representative). In short, those who are misclassified as independent contractors are deprived of many of the protections to which they would be entitled if they were properly classified as employees.

2. Under federal law – and to a large extent, under state laws as well – independent contractors have modest protection against discrimination in the workplace. For example, the principal federal anti-discrimination statute, Title VII, excludes
independent contractors from its protections. See Brown v. J. Kaz, Inc., 581 F.3d 175, 181 (3d Cir. 2009).

3. Depending on the statute and/or the jurisdiction, independent contractors may be covered under certain anti-discrimination or employment rights laws. Thus, the New Jersey Appellate Division ruled that an independent contractor could proceed with a sexual harassment lawsuit under the New Jersey Law Against Discrimination. See Hoag v. Brown, 397 N.J. Super. 34 (App. Div. 2007).  

4. This general lack of protection contrasts sharply with employees (and even, to some extent, potential employees such as applicants) who are covered by federal and state non-discrimination laws.

C. OTHER EMPLOYMENT-RELATED LIABILITIES

1. The distinction between employees and independent contractors has significance for an employer’s liability exposure arising from the actions of such workers.

2. Under the theory of respondeat superior, an employer is vicariously liable to third-parties for its employees’ actions or omissions because such conduct is imputed to their employer – as long as the employee is acting within the scope of his or her employment.

III. SURVEY OF FEDERAL LAWS – INDEPENDENT CONTRACTOR OR EMPLOYEE?

Workers are generally considered employees when someone else controls how and when they perform their work. In contrast, independent contractors are generally in business for themselves, obtain customers on their own, and control when and how they perform their services. The following “tests” offer guidance on how to make the distinction.

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7 In that case, Hoag, a female social worker, was employed by Correctional Medical Services Inc. (“CMS”), which provided mental health services for state prison inmates. The New Jersey Department of Corrections (“DOC”) is required to care for the health of state-sentenced inmates housed in New Jersey’s correctional system. As part of a privatization of its inmate health care system, the DOC contracted with CMS to provide psychological counseling services to inmates. While working at one of the DOC’s prisons, Hoag alleged that a corrections officer threatened, physically abused and sexually harassed her on a daily basis. She sued under the NJLAD. Id. at 43. A trial court dismissed Hoag’s LAD claim, stating that there was no employer/employee relationship between her and the DOC. However, after interpreting the language of the LAD statute, as well as cases involving employer liability under the Conscientious Employee Protection Act, N.J.S.A. 34:19-1 to -8, the New Jersey Appellate Division reversed and held that an independent contractor can be considered an employee under LAD. Id. at 47-52. In so holding, the Appellate Division found that the state had substantial control over Hoag’s employment – the DOC provided orientation and training sessions for workers; it had the ultimate right to approve the dismissal of CMS personnel; and the DOC monitored daily work and provided daily supervision. Id. at 48-49. The court also found that Hoag’s job duties required close daily interaction with other DOC employees and the DOC provided the workplace and all the office supplies and equipment. Id. at 50. Perhaps most important, the court found that Hoag’s employment was fully integrated into the DOC’s business – she was a necessary part of the counseling program that the DOC was constitutionally mandated to provide and her daily activities were controlled and monitored by the DOC. Id. at 51. Because of all those factors, the Appellate Division concluded that, for purposes of invoking the protections under the LAD, Hoag was an “employee.” Id. at 53.
A. “RIGHT TO CONTROL” TEST

Under the “right to control” test, if the employer controls both the result of the job and the manner and means of accomplishing it, the worker is an employee.

1. Background
   a. Under common law agency principles, an independent contractor/employee inquiry focuses on the “right to control.” The “right to control” test requires an evaluation of all the circumstances surrounding the relationship between the company and the worker, and depends upon a number of factors, none of which is dispositive.

   b. Control of the Result and the “Manner and Means”

   i. To determine whether the hiring party has the “right to control” the conduct of the hired party, courts look to whether the purported employer “has the right to control and direct the work, not only as to the result to be accomplished by the work, but also as to the manner and means by which that result is accomplished.” NLRB v. Steinberg, 182 F.2d 850, 857 (5th Cir. 1950). The extent of the actual supervision exercised by a putative employer over the “means and manner” of the worker’s performance is the most important element to be considered. NLRB v. Associated Diamond Cabs, Inc., 702 F.2d 912 (11th Cir. 1983) (citing NLRB v. Deaton, Inc., 502 F.2d 1221, 1223 (5th Cir. 1975)).

      (A) When the person for whom services are performed retains the right to control the manner and means by which those services are to be accomplished (and particularly when that person provides supervision as to the details of the work), the worker is considered an employee. NLRB v. Gary Enters., 1992 U.S. App. LEXIS 5538 (4th Cir. 1992) (citing Air Transit, Inc. v. NLRB, 679 F.2d 1095, 1098 (4th Cir. 1986)).

   ii. It is the right, and not the exercise of control, which is the determining factor. Associated Diamond Cabs, 702 F.2d at 920.

   c. Investigation of Other Factors

      Federal courts examine a number of factors to determine whether the hiring party has the “right to control” the hired party:
i. The type of services rendered;

ii. Whether the purported employee is engaged in a distinct occupation or business (i.e., the possibility of realizing additional profits through the exercise of entrepreneurial skill);

iii. Whether the worker is subject to the same personnel practices and disciplinary rules as are admitted employees (e.g., access to the hiring party’s grievance procedures);

iv. Whether the work involved is usually done under an employer’s direction or by an unsupervised specialist;

v. The necessary skill involved in completion of the task for which the worker is hired;

vi. The manner in which entrepreneurial risk and reward are allocated (e.g., responsibility for operating costs; which party supplies the instrumentalities; the right to hire assistants or replacements; control over scheduling; place of performance);

vii. Whether the employer provides benefits;

viii. The length of employment;

ix. The method of payment (by time or by the job);

x. The tax treatment of the hired party;

xi. Whether the work is part of the employer’s regular business and/or necessary to it; and

xii. The intent of the parties.

No single factor, standing alone, is decisive. Rather, courts must scrutinize the overall relationship between the worker and the hiring party.

2. National Labor Relations Act (“NLRA”)

   a. The jurisdiction of the NLRB extends only to the relationship between an employer and its “employees”; it does not encompass the relationship between a company and its “independent contractors.”

   b. Under the NLRA, the term “employee” includes “any employee . . . but shall not include . . . any individual having the status of an independent contractor.” 29 U.S.C. § 152(3) (2000).

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8 See, e.g., Lerohl v. Friends of Minn. Sinfonia, 322 F.3d 486, 489 (8th Cir. 2003) (applying “right to control” test to professional musicians).

i. But see AmeriHealth Inc., 329 N.L.R.B. No. 76 (1999), in which the NLRB indicated that it might accord less weight to issues of control and direct supervision in evaluating the employment status of physicians contracting with a managed care organization.

d. No specific formula exists, however, to determine whether a given worker is an independent contractor or employee. Rather, “all of the incidents of the relationship must be assessed and weighed with no one factor being decisive. What is important is that the total factual context is assessed in light of the pertinent common law agency principles.” United Ins. Co., 390 U.S. at 258.

3. Employee Retirement Income Security Act (“ERISA”)

a. To determine if a worker is an employee under ERISA, courts use the right to control test. Misclassifying an employee for benefit purposes can result in significant liability.


i. In Darden, the Supreme Court, construing ERISA’s definition of the term “employee,” remarked that “[w]here Congress uses terms that have accumulated settled meaning under ... the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.... In the past, when Congress has used the term ‘employee’ without defining it, we have concluded that Congress intended to describe the conventional master-servant relationship as understood by common law agency doctrine.” Id. at 322-23.

ii. The Darden Court, applying this “well established” principle, stated that “we do not find ... any provision either giving specific guidance on the term’s meaning or suggesting that construing it to incorporate traditional agency law principles would thwart the congressional design or lead to absurd results.” Id. at 323 (emphasis added).

iii. Accordingly, the Court concluded that “employee” under ERISA must be “read ... to incorporate traditional agency law criteria.” Id. at 319 (emphasis added). The term “employee” should be construed “to incorporate the general common law of agency, rather than ... the law of any particular State.” Id. at 323 n.3 (citation omitted).
iv. In *dicta*, the Court rejected Darden’s assertion that the FLSA’s “economic reality” standard should apply. The definition of “employee” under the FLSA, which “derives from the child labor statutes ... goes beyond its ERISA counterpart.” *Id.* at 326 (citation omitted). Consequently, construction of the term “employee” under ERISA cannot rely on the “economic reality” test adopted in FLSA cases.

v. The “hiring party’s right to control the manner and means by which the product is accomplished” is considered. *Id.* at 323 (emphasis added).

d. The following factors, none of which are dispositive, must be considered:

i. The skill required to perform the task at issue;

ii. The source of the instrumentalities and tools;

iii. The location of the work;

iv. The duration of the relationship between the parties;

v. Whether the hiring party has the right to assign additional projects to the hired party;

vi. The extent of the hiring party’s discretion over when and how long to work;

vii. The method of payment;

viii. The hired party’s role in hiring and paying assistants;

ix. Whether the work is part of the regular business of the hiring party;

x. Whether the hiring party is in business;

xi. The provision of employee benefits; and

xii. The tax treatment of the hired party.

e. *Vizcaino v. Microsoft Corp.*, 97 F.3d 1187 (1996), involved a group of freelancers hired by Microsoft as independent contractors who were later determined by the IRS to be “common law employees” for federal tax purposes. The freelancers were: hired with the understanding that they would not be eligible for benefits; paid through the accounts receivable department instead of through Microsoft’s payroll; and paid higher salaries than comparable common law employees. Following the IRS’s determination, the freelancers sought payment of various employee benefits (*i.e.*, vacation, sick leave and holiday pay, and short-term disability, as well as ERISA-governed health and life insurance benefits, the Microsoft

i. The district court concluded that, with respect to the non-ERISA benefits, the plaintiffs were required to prove that Microsoft made an express or implied promise (i.e., a contract) to provide the benefits. Thus, because the plaintiffs signed documents explicitly acknowledging that they were self-employed and would not be eligible for any employee benefits, the district court recommended that their claims be denied. With respect to the SPP and the ESPP, the district court concluded that the plaintiffs generally had no expectation of receiving benefits and, therefore, denied the plaintiffs’ claims.

ii. The Court of Appeals held that the plaintiffs were eligible to participate in both plans. Although the SPP limited eligibility to employees on the United States payroll of the employer, the court found that the phrase “on the United States payroll of the employer” could include a person paid from Microsoft’s United States accounts (as opposed to foreign accounts) and they concluded that this phrase extends eligibility to the plaintiffs. The Ninth Circuit also held that plaintiffs were eligible to participate in the ESPP because the Code provision applicable to that plan, which Microsoft took advantage of (Code Section 423), requires inclusion of all “common law employees” despite the fact that the plaintiffs signed agreements acknowledging they would not be eligible.

iii. On reconsideration, the Ninth Circuit affirmed its prior decision and held that the plaintiffs were eligible to participate in the ESPP and the SPP. Microsoft stipulated that its workers were, in fact, “employees.” The court stated that Microsoft had made an honest mistake in construing its workers as “independent contractors” and took its various actions and inactions based on that misapprehension. To remedy this unintentional misclassification, Microsoft was required to offer participation in the ESPP and the SPP to all of its “common law employees.” The court also stated that an intentional misclassification would result in strict penalties.

f. Herman v. Time Warner, Inc., 56 F. Supp. 2d 411 (S.D.N.Y. 1999), represents the U.S. DOL’s first civil action addressing the misclassification of contingent workers denied access to company-sponsored employee benefits. The U.S. DOL claimed that Time Warner had misclassified several hundred freelance writers, reporters and photographers as independent contractors and had breached its fiduciary duty under ERISA by accepting the misclassifications and failing to enforce the participation rules of the plan.
i. The court denied Time Warner’s motion to dismiss, holding that the
U.S. DOL had stated a claim for breach of fiduciary duty. Citing the
common law of trusts, the court found that ERISA fiduciaries have a
duty to investigate the identity of plan beneficiaries where the trust
document does not clearly identify them.

ii. Additionally, the court noted that it was appropriate for the
government to take action because misclassified employees may be
unaware that their rights under ERISA have been violated.

g. Tax Ramifications

i. ERISA generally preempts all state law relating to employee benefit
plans except banking, insurance (except for self-insured welfare
plans), securities and criminal law. ERISA § 514.

ii. If individuals are treated as independent contractors, they will not be
included in the various coverage and nondiscrimination tests under
ERISA and the Internal Revenue Code and will not be afforded the
protections of ERISA (e.g., vesting, prohibitions against reductions
in benefits). However, any claims for benefit eligibility, denial, etc.,
could be brought under state law (e.g., breach of contract).

iii. To the extent provided under state law, an individual may have
greater rights than those provided under ERISA (e.g., ERISA does
not provide for punitive damages, state law may differ).

iv. An independent contractor cannot participate in a tax qualified
retirement plan sponsored by the entity retaining such contractor’s
services (because these plans can only cover employees and their
beneficiaries). However, an independent contractor may be able to
sponsor a Keogh plan to defer income.

v. Although an independent contractor could participate in a
company’s health plans (unless prohibited by the insurance
policy/plan document), any contributions made to these plans on the
independent contractor’s behalf (e.g., premium payments) would be
includable in the gross income of the independent contractor (i.e.,
the Internal Revenue Code § 106 exclusion from an employee’s
gross income of employer-provided coverage under an accident or
health plan would not apply).

4. Internal Revenue Code of 1986 (The “Code”)

a. For any large organization, managing the risks of using independent
contractors is a tremendous burden. The question of 1099 or W-2 worker
classification is perplexing, and misclassifying an employee can have
significant tax liability.
b. The determination of a service provider’s employment status is important for purposes of: (i) determining a service recipient’s federal income and employment tax liabilities and withholding obligations; and (ii) satisfying various participation, coverage and nondiscrimination requirements with respect to tax qualified benefit plans.

c. Under the Code, the relationship of employee and employer exists when the person or persons for whom services are performed have the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also the details and means by which that result is accomplished.

i. It is not necessary that the service recipient actually direct or control the manner in which the services are performed; it is sufficient if the service provider has the right to do so.

ii. The common law standard is relevant for purposes of determining “employee” status for certain aspects of the service relationship (i.e., federal tax coverage and for testing purposes under welfare and pension plans subject to ERISA).

d. As an aid to determine whether the requisite control or the right to control is sufficient to establish the employer/employee relationship, the IRS set forth 20 factors in Rev. Rul. 87-41, 1987-1 C.B. 296 as a guideline:

i. Whether the worker must comply with instructions of the person for whom the worker provides services as to when, where and how the worker is to perform services;

ii. Whether the service recipient trains the worker;

iii. Whether the success of the service recipient’s business is dependent upon the worker’s services;

iv. Whether the worker must render services personally;

v. Whether the service recipient hires, supervises or pays individuals assisting the worker;

vi. Whether there is a continuing relationship between the service recipient and the worker;

vii. Whether the service recipient determines the worker’s hours;

viii. Whether the worker’s services must be devoted substantially full time to the service recipient;

ix. Whether the worker must perform his or her services on the service recipient’s premises;
x. Whether the worker must perform his or her services in the sequence determined by the service recipient;

xi. Whether the worker must submit reports to the service recipient;

xii. Whether the service recipient pays the worker by the hour, week or month rather than by the job or on a commission basis;

xiii. Whether the service recipient pays the worker’s business or travel expenses;

xiv. Whether the service recipient furnishes the worker’s tools, materials and other equipment;

xv. Whether the worker has a significant investment in the business;

xvi. Whether the worker has a risk of economic loss or opportunity for profit;

xvii. Whether the worker performs services for more than one service recipient;

xviii. Whether the worker makes his or her services available to the general public;

xix. Whether the service recipient has the right to discharge the worker; and

xx. Whether the worker has the right to terminate his or her relationship with the service recipient.

e. A problem related to classifying workers as employees or independent contractors is determining who is an employer where services are rendered via an intermediary. The question that arises is whether the worker is an employee of either the service provider, the service recipient, or both.

i. In that situation, the IRS generally will apply the 20-factor common law test.

ii. Similarly, courts have applied the 20-factor test in the context of employee leasing arrangements.

f. On March 4, 1997, the IRS released a revised version of its Worker Classification Training Manual (the “Manual”), which provides guidance to its employment tax specialists and revenue officer examiners on how to make “impartial” determinations of a worker’s employment status for federal employment tax purposes.

g. Although the Manual elaborates on certain factors included in the twenty-factor test, the Manual specifically provides that the twenty common law
factors listed above are not the only ones that may be important. The Manual provides that the relative weight of each of the twenty factors can vary significantly depending on the specific situation under examination.

h. In providing guidance regarding the common law control standard, the Manual discusses the elements of “behavioral control,” “financial control” and the “relationship of the parties.”

i. The Manual provides that the relationship of the parties, as seen by the parties, is important because it reflects the parties’ intent concerning control. A written agreement describing a worker as an independent contractor is viewed as evidence of the parties’ intent that a worker is an independent contractor, but is not dispositive.

j. The Manual states that with respect to a worker who creates a corporation through which to perform services, (i) the corporate form generally will be recognized for both state and federal law, including federal tax purposes, provided that the corporate formalities are followed and at least one non-tax business purpose for the corporate form exists (e.g., to limit liability) and (ii) that disregarding the corporate entity generally will be an extraordinary remedy. This is a significant change from the draft version of the Manual released in February, 1996 and was first introduced in the final version of the Manual released on August 6, 1996. In March of 1996, the IRS implemented the Classified Settlement Program (“CSP”). The CSP is a voluntary program that permits businesses and tax examiners to resolve worker classification cases as early in the administrative process as possible, thereby reducing taxpayer burden.

5. **Section 530 of the Revenue Act of 1978**

a. Section 530 provides a safe harbor for a business if it improperly classifies an employee as an independent contractor. Under Section 530, a business can continue to treat its workers as independent contractors (even if, under the 20-factor test, they might be considered employees) and be relieved of employment tax and income tax withholding liability, including any interest or penalties. To benefit from Section 530, the business must have:

i. Properly filed all federal tax returns and Forms 1099;

ii. Treated, for employment tax purposes, all of its workers holding substantially similar positions in the same manner; and

iii. Had some reasonable basis for not treating the workers as employees.
6. **Unemployment Compensation**

   a. Generally, a business could be found liable for unemployment insurance withholding in the state in which the business resides if a temporary worker files for unemployment insurance benefits that are provided by state funds to “employees” and a state agency determines that the applicant is an employee and not an independent contractor.

   b. However, an out-of-state telecommuting employee is not entitled to the unemployment insurance benefits in the state in which the employer’s business resides. *In re Claim of Allen*, 100 N.Y.2d 282 (2003) (holding that employee working from her home in Florida for the company located in New York was not entitled to receive unemployment insurance benefits from New York because the employee was physically present in Florida rather than New York).

   c. In Florida, *Cantor v. Cochran*, 184 So. 2d 173 (Fla. 1966), sets forth the factors considered to determine whether a person is an employee or independent contractor:

      i. the extent of control which, by the agreement, the master may exercise over the details of the work;

      ii. whether or not the one employed is engaged in a distinct occupation or business;

      iii. the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;

      iv. the skill required in the particular occupation;

      v. whether the employer or workman supplies the instrumentalities, tools, and a place of work for the person doing the work;

      vi. the length of time for which the person is employed;

      vii. the method of payment, whether by the time or by the job;

      viii. whether or not the work is a part of regular business of the employer;

      ix. whether or not the parties believe they are creating the relation of master and servant; and

      x. whether the principal is or is not in business.

   d. The Florida Department of Revenue “Unemployment Compensation Employer Handbook” defines an employee for purposes of the Florida Unemployment Compensation Laws as an employee under the common law
rules for employer employee relations. More specifically, an employee is a person who is subject to the will and control of the employer not only as to what shall be done, but how it shall be done.\textsuperscript{9}

e. The Florida Unemployment Compensation Employer Handbook likewise defines an independent contractor as one who is not subject to the will and control of the employer. Further:

i. Independent contractors hold themselves out to the public as such;

ii. Generally, the independent contractors furnish their own materials and labor and use their own tools in performance of the work;

iii. Services performed by independent contractors cannot be summarily terminated without recourse;

iv. A contract for labor only will normally be considered a contract for employment;

v. How the worker is treated, not a written contract, determines employment status.\textsuperscript{10}

f. In California, \textit{Zaremba v. Miller}, 113 Cal. App. 3d Supp 1 (1980), established that the most important factor is the right to control the manner and means of accomplishing the results desired. If the employer has the authority to exercise complete control, whether or not that right is exercised with respect to all the details, an employer-employee relationship exists. Strong evidence in support of an employment relationship is the right to discharge at will, without cause. Other factors taken into consideration are:

i. whether or not the one employed is engaged in a distinct occupation or business;

ii. the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;

iii. the skill required in the particular occupation;

iv. whether the employer or workman supplies the instrumentalities, tools, and a place of work for the person doing the work;

v. the length of time for which the services are to be performed;


\textsuperscript{10} \textit{See id.}
vi. the method of payment, whether by the time or by the job;

vii. whether or not the work is a part of regular business of the employer; and

viii. whether or not the parties believe they are creating the relation of master and servant.

g. In New York, Leone v. United States, 910 F.2d 46 (2d Cir. 1990), sets forth the factors often considered to determine whether a person is an employee or independent contractor:

i. the extent of control which, by the agreement, the master may exercise over the details of the work;

ii. whether or not the one employed is engaged in a distinct occupation or business;

iii. the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;

iv. the skill required in the particular occupation;

v. whether the employer or workman supplies the instrumentalities, tools, and a place of work for the person doing the work; and

vi. the method of payment, whether by the time or by the job.  Id. at 50.11

h. New York State Unemployment Insurance Law defines “employment” as “any service or contract of employment for hire, express or implied, written or oral,” and “any service by a person for an employer.”  N.Y. Unempl. Ins. Law § 512.  To determine whether an individual is an independent contractor or any employee, the New York Department of Labor applies the common law “right to control” test as described in guidance that the issued. See N.Y. STATE DEP’T OF LAB. UNEMPLOYMENT INS. DIV., Independent Contractors [hereinafter “DOL Guidance on Independent Contractors”], http://www.labor.ny.gov/ui/pdfs/ia31814.pdf (last accessed Aug 26, 2011).

i. The New York Department of Labor has also issued legal guidance on factors indicating an employment relationship versus an independent contractor relationship for purposes of its unemployment insurance law.12 Factors weighing in favor of an employment relationship include:

11 See also Fraser v. United States, 490 F. Supp. 2d 302, 310 (E.D.N.Y. 2007) (applying the Leone factors to determine if construction worker is an independent contractor).

i. Control over the individual’s activities by such means as requiring full-time services, stipulating the hours of work, requiring attendance at meetings, and requiring prior permission for absence from work;

ii. Requiring the individual to comply with instruction as to when, where, and how to do the job;

iii. Direct supervision over the services performed;

iv. Providing facilities, equipment, tools, or supplies for the performance of the services;

v. Setting the rate of pay for service performed;

vi. Providing compensation in the form of a salary, an hourly rate of pay, or a drawing account against future commissions with no requirement for repayment of unearned commissions;

vii. Providing reimbursement or allowance for business or travel expenses;

viii. Providing fringe benefits;

ix. Providing training, particularly if attendance at training sessions is required;

x. Establishment of limits within which the individual must operate: territorial, monetary, or time limits;

xi. Requiring services to be rendered personally;

xii. Requiring oral or written reports;

xiii. Services performed are an integral part of the business, particularly when performed on a continuing basis;

xiv. Furnishing business cards, or other means of identification of the individual as a representative of the employer;

xv. Restricting the individual from performing services for competitive businesses;

The New York Department of Labor’s Recent 2009 Annual Report of the Joint Enforcement Task Force of Employee Misclassification states that the “essential elements of the common law test involve determining whether the worker is subject to the control and supervision of the employer and rendering services that are an integral part of the employer’s business or whether the worker is genuinely involved in an independent business offering services to the public and assuming the profit and risk of providing services.”
xvi. Reservation of the right to terminate the services on short notice; and

xvii. Nature of services: unskilled labor is usually supervised, or considered to be subject to supervision.

j. On the other hand, NYDOL has established the following factors that suggest an independent contractor relationship:

i. The individual is established in an independent business offering services to the public. An independent business is usually marked by such elements as media advertising, commercial telephone listing, business cards, business stationery and billheads, carrying business insurance, maintaining own establishment;

ii. The individual has a significant investment in facilities. Such items as hand tools and personal transportation are not considered significant;

iii. Assumption of the risk for profit or loss in providing services;

iv. Freedom to establish own hours of work and to schedule own activities;

v. No required attendance at meetings or training sessions; no required oral or written reports; and

vi. Freedom to provide services concurrently for other businesses, competitive or non-competitive.

k. Courts generally focus on the amount of control a business exerts over a worker. The primary factor to be considered is the degree of control over the mode or details of the work. See, e.g., Bynog v. Cipriani Group, Inc., 1 N.Y.3d 193, 198 (2003); Freedom Labor Contractors of Fla., Inc. v. State of Fla., Div. of Unemployment Comp., 779 So. 2d 663 (Fla. 3d DCA 2001); Carroll v. Fed. Express Corp., 1995 U.S. Dist. LEXIS 12026 (N.D. Cal. Aug. 15, 1995); In re Polinsky, 163 A.D.2d 684 (3d Dep’t 1990).

l. The factors relevant to assessing control include whether the worker: (i) worked at his own convenience; (ii) was free to engage in other employment; (iii) received fringe benefits; (iv) was on the employer’s payroll; and (v) was on a fixed schedule. See Bynog, 1 N.Y. 3d at 198; Gagen v. Kipany Prods, Ltd., 27 A.D.3d 1042, 1043 (3d Dep’t 2006) (applying Bynog’s five factors).

m. Note, however, that an employer may still retain some modicum of control without creating an employer/employee relationship. See e.g., Williams v. C.F. Med., Inc., 2009 WL 577760, at *1 (N.D.N.Y. Mar. 24, 2009) (“While it is true that certain requirements and limits were imposed upon Plaintiff by
Defendant, “[s]ome control by the employer over the [hired] party remains consistent with a finding that the [hired] party is an independent contractor”

B. “ECONOMIC REALITY” TEST

Under the “economic reality” test, if the worker is highly dependent on the employer for his economic existence, the worker will be deemed an employee even if the employer does not have full right to control.

1. Background

a. Under the “economic reality” test, courts examine a number of factors. The test is based on the “totality of circumstances,” and no one factor is dispositive. See Rutherford Food Corp. v. McComb, 331 U.S. 722, 730 (1947).

b. The following factors, derived from United States v. Silk, 331 U.S. 704, 716 (1947),14 are examined under the “economic reality” test:

i. The degree of control exerted by the alleged employer over the workers;

ii. The workers’ opportunity for profit or loss and their investment in the business;

iii. The degree of skill and independent initiative required to perform the work;

iv. The permanence or duration of the working relationship; and

v. The extent to which the work is an integral part of the employer’s business.

c. Courts also have included or utilized the following factors in applying the “economic reality” test, such as whether the alleged employer:

i. Had the power to hire and fire the workers;

ii. Supervised and controlled employee work schedules or conditions of employment;

iii. Determined the rate and method of employment; and

iv. Maintained employment records.

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14 While Silk involved a question of employment status under the Social Security Act, the FLSA and the Social Security Act have similar social welfare purposes. Thus, the findings in Silk have been applied in FLSA cases as well. See, e.g., Whitaker House Coop., Inc., 366 U.S. 28, 33 (1961) (adopting the “economic reality” standard in FLSA case, citing Silk).
2. **Fair Labor Standards Act ("FLSA")**

   a. The term “employee” is defined broadly under the FLSA. 29 U.S.C. § 203(e) (2000); see also *United States v. Rosenwasser*, 323 U.S. 360, 363 n.3 (1945) (the FLSA’s definition of employee is the “broadest definition that has ever been included in any one act”). Under the FLSA, an employee includes “any individual employed by an employer,” with some specific, narrowly interpreted exemptions. 29 U.S.C. § 203(e) (2000).

   b. The FLSA defines the term “employ” as “suffer or permit to work.” 29 U.S.C. § 203(g) (2000).


3. **Interns, Trainees and Volunteers under the FLSA**

   a. Interns and Trainees

   i. Whether interns or trainees are employees for purposes of the FLSA’s minimum wage and overtime requirements depends on “all the circumstances surrounding their activities.”

   ii. The U.S. DOL (interpreting the FLSA) has consistently applied a six-factor test in determining whether an employment relationship exists or whether someone is appropriately retained as a trainee or intern and, thus, exempt from federal/state minimum wage laws. The six criteria, derived from the Supreme Court’s opinion in *Walling v. Portland Terminal Co.*, 330 U.S. 148 (1947), provide that where training programs are designed to provide students with professional experience in the furtherance of their education, and the training is academically oriented for the benefit of the students, the students are not considered employees.

   iii. Thus, interns are not considered “employees” under federal law when all six of the following criteria are met: (1) the training, even though it includes actual operation of the facilities of the employer, is similar to that which would be given in a vocational school; (2) the training is for the benefit of the trainee; (3) the trainees do not displace regular employees, but work under close observation; (4) the employer that provides the training derives no immediate

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advantage from the activities of the trainees and on occasion the employer’s operations may actually be impeded; (5) the trainees are not necessarily entitled to a job at the completion of the training period; and (6) the employer and the trainee understand that the trainees are not entitled to wages for the time spent in training.

iv. These factors reflect the language of a 2006 opinion letter in which WHD stated that no employment relationship will exist between an employer and its interns where the experience of the intern is akin to one that would be received in a vocational school. Wage & Hour Op. Letter, FLSA 2006-12 (Apr. 6, 2006).

v. Irrespective of how an individual is described – intern, trainee, apprentice, extern or volunteer – the ultimate inquiry, under the FLSA, is whether he or she is suffered or permitted to work or falls within the six-factor test. While most federal courts have followed the Walling principles and the U.S. DOL’s six-factor test, there is judicial precedent for looking at the totality of the circumstances, rather than applying a rigid approach, and examining which party benefits the most from the relationship – the employer or the alleged “intern.” See Reich v. Parker Fire Protection Dist., 992 F.2d 1023, 1027 (10th Cir 1993).

vi. States may have additional criteria for evaluating whether an “intern” is an employee.

b. Volunteers

i. In Tony & Susan Alamo Foundation v. Secretary of Labor, 471 U.S. 290 (1985), the Supreme Court held that a non-profit religious foundation’s workers were “employees” within the meaning of the FLSA, notwithstanding the fact that not one witness was produced who viewed his work in the Foundation’s commercial business as anything other than volunteering services. The Alamo Foundation was staffed mostly by “associates” – who did not receive any cash salaries – but who were provided with food, clothing, shelter, and other benefits for long periods of time, sometimes years. Id. at 292.

While the associates who testified vehemently protested any desire for “compensation” from the Foundation, and vigorously asserted that they considered themselves volunteers who were working only for religious and evangelical reasons, the Supreme Court nevertheless concluded that the “associates” were in fact “employees.” Id. at 302.

ii. The Supreme Court agreed with the district court’s reasoning that, because the individuals were “entirely dependent upon the Foundation for long periods,” they must have expected “in-kind benefits…in exchange for their services.” Id. at 301. That exchange was clearly not within the purview of the FLSA’s permissible
payments to volunteers of reasonable benefits, expenses, or nominal fees. 29 U.S.C. § 203(e)(4). Based on the economic reality of the situation, the Supreme Court upheld the lower court’s ruling that the individuals were employees.

iii. No Volunteer Exemption for Services Provided to Private, For-Profit Employers

(A) Under no circumstance will an individual be deemed a volunteer when providing services to private, for-profit employers under the FLSA. The FLSA has no statutory provision permitting employees of private, not-for-profit employers, such as private universities, to volunteer their services. However, for enforcement purposes, the Wage-Hour Division of the U.S. DOL applies the same policy and factors enumerated in the public sector context to employees of religious, charitable, or nonprofit organizations who donate their services as volunteers to their employing organization. See Field Operations Handbook § 10b03(d). However, the U.S. DOL’s enforcement position does not waive, or have any effect on, an individual employee’s right under section 16(b) of the FLSA bring a cause of action seeking compensation for “volunteer” hours. See Wage and Hour Opinion Letter, FLSA 2004-6 (Q.2 at 2).

iv. Exemption of Volunteers from the Requirements of the FLSA Applies Only to Public Sector Employees

(A) Following the Supreme Court’s decision in Tony & Susan Alamo Foundation, Congress amended the FLSA in 1985 to create an exemption for volunteers who perform services for a public agency and who satisfy enumerated criteria. In so doing, Congress intended to ensure that true volunteer activities will not be impeded or discouraged while minimizing the risk that the FLSA’s minimum wage and overtime requirements will be subject to abuse by employers.

(B) The FLSA and its regulations permit public sector employees to volunteer their services to their employing public agency, without defeating “volunteer” status, assuming all of the following criteria are met: (1) they provide their services for civic, charitable or humanitarian reasons; (2) they provide their services free from coercion or pressure; (3) they do not volunteer to provide the same type of services for which they are employed by that very public agency; (4) their hours of service are provided with no promise, expectation, or receipt of compensation for the services rendered except for reimbursement for expenses,
reasonable benefits, and nominal fees, or a combination of the above; (5) the volunteer services do not occur during the employee’s regular working hours; (6) the time spent devoted to volunteering is insubstantial compared to the employee’s regular work hours; and (7) the volunteers do not impair job opportunities of other employees. See 29 U.S.C. § 203(e)(4)(A); 29 C.F.R. § 553.101, 553.103, 553.104; and 553.106.  


   a. On May 24, 1999, two former AOL “Community Leader” volunteers filed a collective action under the FLSA and a class action under New York state law against America Online and AOL Community, Inc. (collectively, “AOL”), in the United States District Court for the Southern District of New York. The plaintiffs alleged that, in serving as Community Leader volunteers, they were acting as employees rather than volunteers for purposes of the FLSA and New York state law and were thus entitled to minimum wages.  

   b. From the 1990s through June 2005, AOL utilized “volunteers” (i.e., Community Leaders) to perform a number of functions, including chat room monitoring. Volunteers had to apply for a position and, if accepted, sign an agreement to commit three to four hours of work per week. In exchange for their services, AOL provided free internet service to the volunteers. Community Leaders also received special accounts that allowed them to restrict disruptive chat, hide inappropriate message board postings, and access private areas on the AOL service, such as the Community Leader Headquarters (CLHQ). Thousands of individuals performed unpaid “volunteer” work for AOL through its “Community Leader” program during that time period.  

   c. In December 2000, AOL filed a motion to dismiss on the ground that the plaintiffs were volunteers and not employees covered by the FLSA. The plaintiffs argued that the Community Leader position required a significant

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16 *See also* Wage and Hour Opinion Letter, No. 1422 (WH-369) (Dec. 3, 1975).  
17 In June 2001, a related case, *Williams v. Am. Online Inc.*, 01-Civ-04927 (KTD), was filed by several of the *Hallissey* plaintiffs in the United States District Court for the Southern District of New York alleging violations of the retaliation provisions of the FLSA. That case was stayed pending the outcome of the *Hallissey* motion to dismiss. No activity has occurred in that case since its filing. From July through October 2001, three related class actions were filed in state courts in New Jersey, California and Ohio, alleging violations of the FLSA and respective state laws. The New Jersey and Ohio cases have been removed and transferred to the United States District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings. The California case, which consisted only of state law claims, was remanded to state court based on the plaintiffs’ assertion that their claims did not exceed $75,000. That case was settled in 2006 after class certification was denied. On January 17, 2002, Community Leader volunteers filed a class action lawsuit in the United States District Court for the Southern District of New York against AOL Time Warner, America Online and AOL Community, Inc. under ERISA. Plaintiffs alleged that, in serving as Community Leader volunteers, they were acting as employees rather than volunteers and are entitled to pension and/or welfare benefits and/or other employee benefits subject to ERISA.
amount of effort and detail. The plaintiffs asserted that Community Leaders had to undergo a thorough, 3-month training program and were required to file timecards for shifts, work at least four hours per week, and submit detailed reports outlining their work activity during each shift. The motion to dismiss was denied.

d. In March 2006, after years of litigation, Judge Kevin Duffy of the District Court for the Southern District of New York denied AOL’s motion for summary judgment and held that, even though a Community Leader’s classification as an employee or volunteer under FLSA is a question of law, the court must look closely at the facts surrounding the services provided to determine the worker’s FLSA status. Id. at *9. For example, the court found evidence that the services provided by the plaintiffs were substantially similar to those provided by paid employees. Id. at *29-30. Thus, there were factual issues with respect to the precise role that the plaintiffs had in AOL’s business. Id. at *31-32. Another factual issue which compelled the court to deny AOL’s summary judgment motion was whether AOL received direct economic benefit from plaintiffs’ services and, if so, how that benefit compared to those received by the plaintiffs. Id. at *37-38. The court was duly concerned that AOL might have received direct and substantial economic benefit through plaintiffs’ efforts without compensating the Community Leaders for it, which would clearly fly in the face of the spirit of the FLSA. Id. at *38-39.

e. In denying summary judgment, Judge Duffy held that the court was free to decide which factors were relevant, and determined that the following should be considered in the analysis: (1) whether plaintiffs had an expectation of compensation; (2) whether plaintiffs were integral to AOL; (3) whether AOL received any benefits; and (4) whether plaintiffs received any benefits. Id. at *12-39.

f. The court described as “crucial” to this inquiry the question of whether or not the plaintiffs had any express or implied expectation of compensation. Id. at *16.


h. In February 2010, the parties’ joint application for preliminary approval of settlement and notice to class was approved. 18 Final approval followed in

May 2010.19 AOL agreed to settle the lawsuit for $15 million, including $4.5 million for attorneys’ fees and costs. The remainder was divided among the approximately 7,000 class members, with a portion going to charities chosen by the named plaintiffs.20

C. THE “HYBRID” TEST

The “hybrid” test is a combination of the right to control and economic reality tests. The issue of control is predominant.

1. Background

a. Under the “hybrid” test, courts must look at the economic realities of the employment relationship, but the primary focus is on the employer’s right to “control” the manner and means of the worker’s performance. See, e.g., Muhammad v. Dallas County Cnty. Supervision & Corr. Dep’t, 479 F.3d 377, 380 (5th Cir. 2007); West-Anderson v. Choicepoint Servs., Inc., 65 F. App’x 246, 247 (10th Cir. 2003); Speen v. Crown Clothing Corp., 102 F.3d 625, 630 (1st Cir. 1996). Although “control” is the most essential factor in the analysis, it is not dispositive. Speen, 102 F.3d at 630.

b. In addition to the employer’s control over the manner and means of the worker’s performance, courts examine a number of other factors to distinguish an employee from an independent contractor:

i. The kind of occupation, with reference to whether the work usually is done under the direction of a supervisor or is done by a specialist without supervision;

ii. The skill required in the particular occupation;

iii. Whether the “employer” or the individual in question furnishes the equipment used and the place of work;

iv. The length of time during which the individual has worked;

v. The method of payment, whether by time or by the job;

vi. The manner in which the work relationship may be terminated (i.e., by one party or both parties; with or without notice and/or explanation);

vii. Whether annual leave is afforded;


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viii. Whether the work is an integral part of the business of the “employer”;

ix. Whether the worker accumulates retirement benefits;

x. Whether the “employer” pays social security taxes; and

xi. The intention of the parties.

2. Age Discrimination in Employment Act (“ADEA”)

a. The ADEA is a hybrid of the FLSA and Title VII. McKennon v. Nashville Banner Publ’g Co., 513 U.S. 352, 357 (1995). While Congress “intended to incorporate fully the remedies and procedures of the FLSA” in the ADEA, substantively the ADEA was derived from Title VII. Ahlmeier v. Nev. Sys. of Higher Educ., 555 F.3d 1051, 1059 (9th Cir. 2009); Lorillard v. Pons, 434 U.S. 575, 582 (1978).

b. The determination of employee status is a substantive element of an ADEA claim and relates to the Act’s prohibitions rather than its remedies and procedures. Garcia v. Copenhaver, Bell & Assocs., 104 F.3d 1256, 1265 (11th Cir. 1997). In addition, the Tenth Circuit stated in Wheeler v. Hurdman, 825 F.2d 257, 259 (10th Cir. 1987), “whether a plaintiff qualifies as an ‘employee’ under ADEA is both a jurisdictional question and an element of the claim.”

c. Courts generally apply either the “hybrid” test or the “common law agency” test to determine whether an individual is an independent contractor or an employee for purposes of the ADEA.

d. In practice, however, in many jurisdictions, the common law agency test is largely indistinguishable from the hybrid approach. Generally, courts reach the same result under either approach.

e. Several federal courts rely on the Supreme Court’s Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992), decision to hold that “common law agency” principles should be utilized to determine employment status under the ADEA. See, e.g., Weary v. Cochran, 377 F.3d 522, 524 (6th Cir. 2004). These courts acknowledge that the “common law agency” test should be applied where Congress has not provided an “expansive definition” of the term “employ.” See, e.g., Sempier v. Johnson & Higgins, 45 F.3d 724, 728 n.4 (3d Cir. 1995); Barnhart v. N.Y. Life Ins. Co., 141 F.3d 1310 (9th Cir. 1998); Frankel v. Bally, Inc., 987 F.2d 86 (2d Cir. 1993).

f. In Mangram v. General Motors Corp., 108 F.3d 61, 62 (4th Cir. 1997), the court used the “hybrid” test to determine that the plaintiff was not an employee; rather, he was a student in the defendant’s dealership program.
g. The “common law agency test” does not differ materially from the “hybrid” test employed by other courts. “Both the hybrid test and the traditional common law agency test emphasize the hiring party’s right to control the manner and means by which the work is accomplished.” Daughtrey v. Honeywell, Inc., 3 F.3d 1488, 1496 (11th Cir. 1993); see also Lopez v. Massachusetts, 588 F.3d 69, 84 (1st Cir. 2009) (noting that, at common law, the relevant factors defining the master-servant relationship focus on the master’s control over the servant).

3. Title VII

a. Under Title VII of the Civil Rights Act of 1964, the term “employee” is defined as “an individual employed by an employer,” with certain exceptions. 42 U.S.C. § 2000e(f) (2000). This definition offers little insight into its proper scope.

b. Courts generally have utilized one of two tests – the “hybrid” test or the “economic reality” test – to determine whether an individual is an independent contractor or an employee under Title VII. See, e.g., Wojewski v. Rapid City Reg’l Hosp., Inc., 394 F. Supp. 2d 1134, 1140 (D.S.D. 2005), vacated in part, 450 F.3d 338 (8th Cir. 2006) (noting that the Eight Circuit has adopted hybrid standard); Cobb v. Sun Papers, Inc., 673 F.2d 337, 340 (11th Cir. 1982).

c. One court, in finding an insurance agent to be an employee, also took the opportunity to clarify its stance that there is “no functional difference” between the multiple independent contractor tests applied by various courts. Murray v. Principal Fin. Group Inc., 613 F.3d 943, 945 (9th Cir. 2010).


21 The strict common law “has not been applied to federal social welfare and anti-discrimination legislation, since it is considered inconsistent with the remedial purposes behind such legislation.” Mares v. Marsh, 777 F.2d 1066, 1067 (5th Cir. 1985) (applying the “hybrid” test to determine employment status under Title VII). But see Shah v. Deaconess Hosp., 355 F.3d 496, 499 (6th Cir. 2004) (applying the common law agency test to determine whether a hired party is an independent contractor or an employee).
e. Courts do not apply the broader “economic reality” test in Title VII cases because “there is no statement in the [Civil Rights] Act or legislative history of Title VII comparable to one made by Senator Hugo Black (later Justice Black), during the debates on the Fair Labor Standards Act, that the term ‘employee’ in the FLSA was given ‘the broadest definition that has ever been included in any one act.’” _Cobb_, 673 F.2d 337, 340. *See, e.g., Knight v. United Farm Bureau Mut. Ins. Co._, 950 F.2d 377 (7th Cir. 1991).

f. Under Title VII, the “extent of the employer’s right to control the ‘means and manner’ of the worker’s performance is the most important factor to review.” _Moland v. Bil-Mar Foods_, 994 F. Supp. 1061, 1069 (N.D. Iowa 1998) *(citing Spirides v. Reinhardt, 613 F.2d 826, 831 (D.C. Cir. 1979), aff’d, 656 F.2d 900 (D.C. Cir. 1981)).

g. A minority of courts, comprised primarily of the Court of Appeals for the Sixth Circuit, have applied the “economic reality” test to determine whether an individual is an independent contractor or an employee under Title VII. *See, e.g., Eyerman v. Mary Kay Cosmetics, Inc._, 967 F.2d 213, 218 (6th Cir. 1992) *(“independent contractors would be covered by Title VII if, under an economic realities test, they are susceptible to the types of discrimination Title VII meant to [protect]”; _Armbruster v. Quinn_, 711 F.2d 1332 (6th Cir. 1983) *(the “term ‘employee’ was [not] meant in a technical sense, divorced from the broadly humanitarian goals of the Act.”)*22.

4. Americans with Disabilities Act (“ADA”)

a. Under the ADA, the term “employee” is defined as “an individual employed by an employer.” 42 U.S.C. § 12111(4) (2000). The definition of employee under the ADA is identical to that of Title VII.

b. The courts are split on whether the “economic realities”, common law “right to control” or hybrid test should be applied to determine a worker’s status for the purposes of his/her ADA claim. *See De Jesus v. LTT Card Servs., Inc._, 474 F.3d 16 (1st Cir. 2007) *(holding that if the individual is subject to the organization’s control, he is an “employee,” for purpose of determining application of the ADA, even if he is a partner, officer, director, or major shareholder); _Schwieger v. Farm Bureau Ins. Co._, 207 F.3d 480, 483 (8th Cir. 2000); _Birchem v. Knights of Columbus_, 116 F.3d 310 (8th Cir. 1997) *(weighing the common law factors listed in the Restatement (Second) of Agency § 220(2) and some additional factors related to the worker’s economic situation); _Hanson v. Friends of Minn. Sinfonia_, 181 F. Supp. 2d 1003 (D. Minn. 2002) *(using the hybrid test to determine whether the hired person was actually an employee or an

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22 Although not explicitly overruled, the economic realities test has been questioned by the Sixth Circuit. _Simpson v. Ernst & Young_, 100 F.3d 436, 442 (6th Cir. 1996). Other circuits expressly have repudiated application of the economic realities test. *See, e.g., Wilde v. County of Kandiyohi_, 15 F.3d 103, 106 (8th Cir. 1994) *(“[b]ecause the economic realities test is based on the premise that the term should be construed in light of Title VII’s purpose and the construction is broader than at common law, _Darden_ precludes the test’s application”)*.
independent contractor within the purview of ADA); *Norberg v. Tillamook County Creamery Ass’n*, 74 F. Supp. 2d 1002 (D. Or. 1999) (holding that “economic realities” test was applicable to determine whether a truck driver was an employee or an independent contractor for the purposes of his ADA claim); *Douglas v. Victor Capital Group*, 21 F. Supp. 2d 379 (S.D.N.Y. 1998) (stating that the question of whether an employment relationship exists for purposes of the ADA is determined primarily by the test known as “control test”, which involves a determination of whether the hiring party controls the manner and means by which work is performed); *Van Ratliff v. Christ Hosp. & Med. Or.*, No 96-C-4916, 1997 U.S. Dist. LEXIS 13586 (N.D. Ill. Aug. 28, 1997) (employing common law “right to control” test to determine plaintiff’s employment status).

c. The EEOC has taken the position that the analysis under the ADA should be the same as under Title VII.23 The EEOC Guidelines state that the *Darden* common law “right to control” test rationale applies under the EEO statutes because the ERISA definition of “employee” is identical to that in Title VII, the ADEA, and the ADA.24

d. One commentator has noted that “the legislative history of the ADA and its remedial purpose clearly demonstrate that a very broad reading of ‘employee’ will arise from review.”25

D. THE D.C. CIRCUIT AND THE “ENTREPRENEURIAL TEST”

1. The D.C. Circuit Court of Appeals applied a new “entrepreneurial test” to determine independent contractor status under the National Labor Relations Act (“NLRA”) in *FedEx Home Delivery v. NLRB*, 563 F.3d 492 (D.C. Cir. 2009).

2. Background

a. The International Brotherhood of Teamsters (“Teamsters”) was certified as the collective bargaining representative for two FedEx locations. FedEx refused to bargain with the Teamsters on the grounds that its single-route drivers were not “employees” under the NLRA. The National Labor Relations Board (“Board”) found that the drivers were employees and that FedEx was in violation of the Act for refusing to bargain with the Teamsters.

b. On appeal, the D.C. Circuit stated that the “non-exhaustive ten-factor [common law] test is not especially amenable to any sort of bright-line rule.” *Id.* at 496. The court observed that, since the Board has no authority over independent contractors, the agency test is “particularly problematic.”

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24 *Id.*

The court also noted that past decisions focused on the extent of control exercised over the workers, but those decisions had failed to capture exactly what was meant by “control.” \textit{Id.} at 497. The court determined that its decision in \textit{Corporate Express Delivery Systems v. NLRB}, 292 F.3d 777 (D.C. Cir. 2002), more accurately captured the correct interpretation of “control” by focusing the inquiry on whether the workers have “significant entrepreneurial opportunity for gain or loss.” \textit{Id.}

3. In determining that the FedEx drivers at issue were actually independent contractors, the court focused on the fact that the drivers could:
   a. set their own hours;
   b. provide their own vehicles;
   c. use the vehicles for personal purposes;
   d. hire their own employees;
   e. hire replacement drivers without FedEx’s consent; and
   f. assign their contractual rights to their routes without FedEx’s consent, and even profit from the sale. \textit{Id.} at 498-99.

4. The court rejected the notion that wearing a FedEx uniform is evidence of an employment relationship, and concluded that such requirements are more akin to safety measures (and not a way for FedEx to exercise control over the drivers). \textit{Id.} at 500-01. Likewise, the failure of some drivers to take advantage of the entrepreneurial opportunities available to them is irrelevant to the inquiry as to whether they can be considered “employees.” \textit{Id.} at 502.

5. Though the court took pains to state that it had examined the factors of the traditional right-of-control test, it explained that an “entrepreneurial opportunity” is the most important consideration of all. \textit{Id.} at 497. The court concluded that, taking into account all of the factors, a finding of independent contractor status was warranted. \textit{Id.} at 502.

6. This case will likely have a significant impact given that the D.C. Circuit has concurrent jurisdiction to review every order issued by the Board, and its decisions on labor issues are generally well-regarded by other courts.

IV. RECENT LITIGATION- 
\textit{FED EX}

Often referred to as the “poster child” for the contractor battle,\textsuperscript{26} FedEx Ground has faced an onslaught of litigation over its use of independent contractors to perform package deliveries as part

of a model that has allowed it to compete directly with United Parcel Service. FedEx drivers, generally, allege that FedEx has “intentionally and consistently misclassified drivers as independent contractors even though they are in reality employees.” This conflict is not new with respect to delivery drivers- the issue was addressed three times with respect to FedEx Ground’s predecessor, Roadway Package Systems. In each of those cases, the NLRB consistently found the drivers to be employees. Roadway Package Sys. (Roadway I), 288 N.L.R.B. 196, 199 (1988); Roadway Package Sys. (Roadway II), 292 N.L.R.B. 376, 378 (1989), aff’d, 902 F.2d 34 (6th Cir. 1990); Roadway Package Sys. (Roadway III), 326 N.L.R.B. 842 (1998).

A. **FEDEX’ RELATIONSHIP WITH ITS DRIVERS**

1. Each FedEx contractor must pass a physical and drug test, and have a good driving record prior to commencing work. Each driver must also either purchase or rent a vehicle satisfying FedEx’s specifications. In re FedEx Home Delivery & Truck Drivers Union, Local 170, Case 1-RC-21966, 2006 WL 897609, at *3 (N.L.R.B. Jan. 24, 2006). This expense may run between $20,000 and $37,000. Id.

2. Drivers must sign a non-negotiable Operating Agreement, which provides that the driver will operate as an independent contractor. This agreement contains a provision that grants the driver some discretion to determine the manner in which he/she achieves goals. It further provides that FedEx does not have the authority to prescribe hours of work, driver routes, or other details of the manner in which work must be performed.

3. FedEx trains its drivers in delivery and loading techniques. However, FedEx maintains that such procedures are “merely suggestions which do not have to be followed.” FedEx Ground Package Sys., Inc. & FXG-HD Drivers Ass’n, Case 4-RC-20974, at 4 (N.L.R.B. June 1, 2005).

4. FedEx maintains strict requirements pertaining to physical appearance of its drivers, including a uniform requirement, and rules about tattoos, earrings, and hair length.

B. **FEDEX’S CONTROL OVER DAILY ACTIVITIES**

1. In addition to the nature of the relationship, some courts have focused on several broader aspects of driver work to conclude that such drivers are employees rather than independent contractors.  

2. **Employer Direction**- Courts have concluded that the work performed by drivers is typically done at FedEx’s direction. In support of this conclusion, one court noted that FedEx routinely hires temporary drivers when a contract route has not been

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3. **Skill**- Drivers need not have any specific skill or experience to carry out their duties effectively. Driving experience and minimal training—usually on safety and delivery policies—are the core requirements. FedEx does not consider its drivers to be specialists. *FedEx Home Delivery & Int’l Bhd. of Teamsters, Local Union No. 671*, Case 34-RC-2205, at 30 (N.L.R.B. Apr. 11, 2007). See also *In re FedEx Home Delivery & Truck Drivers Union, Local 170, Int’l Bhd. of Teamsters*, Case 1-RC-21966, 2006 WL 897609, at *3.

4. **Tools and Place of Work**- While drivers are responsible for making their own vehicle arrangements, FedEx provides other tools such as general liability insurance and directions for all deliveries on their routes. *In re FedEx Home Delivery & Truck Drivers Union, Local 170, Int’l Bhd. of Teamsters*, Case 1-RC-21966, 2006 WL 897609, at *13.

5. **Length of Relationship**
   a. Drivers can contract with FedEx for successive one-year terms. Such contracts may be terminated by either side with 30 days notice. *In re FedEx Home Delivery & Truck Drivers Union, Local 170, Int’l Bhd. of Teamsters*, Case 1-RC-21966, 2006 WL 897609, at *5.
   
   b. Courts have struggled to discern the true level of turnover at FedEx. For example, one court noted that there was “considerable turnover” among the drivers, *FedEx Ground Package Sys., Inc. & FXG-HD Drivers Ass’n*, Case 4-RC-20974, at 16, while another noted an eight year average length of “employment” in another market. *Estrada v. FedEx Ground Package Sys., Inc.*, 64 Cal. Rptr. 3d 327, 333 (Cal. Ct. App. 2007).

6. **Compensation Method**- Drivers’ rates are unilaterally determined by FedEx, and are non-negotiable. “Thus, even though FedEx looks for drivers with an ‘entrepreneurial spirit’, the drivers’ actual compensation is more determined by the number of packages they are assigned by the terminal manager on any given day, rather than any personal effort on their part or entrepreneurial ingenuity.”

7. **Part of the Employer’s Business**- The courts agree that drivers perform a function that is “regular and essential” to FedEx Ground’s package delivery operation.

8. Several decisions have found that FedEx also exercises substantial control over the daily details of driver’s performance. Examples of this are the requirements that drivers provide daily service Tuesday through Saturday; deliver all packages assigned to them the day they are received in the terminal; “deliver all packages for

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destinations outside their route” that are assigned to them by the terminal manager; scan all packages with the FedEx scanner when the packages are loaded onto their vehicle, and then again when the packages are delivered; leave the terminal only after they are permitted by the terminal manager; “use certain approved vehicles” for deliveries; wear FedEx uniforms and FedEx identification badges; “maintain their vehicles in a clean and presentable fashion,” free of damage and markings, and prominently displaying the FedEx logo and colors; “purchase insurance in types and amounts” specified by FedEx; allow FedEx managers “to ride along with them several times annually;” and follow FedEx’s policies and practices with respect to package delivery. FedEx Home Delivery & Int’l Bhd. of Teamsters, Local Union No. 671, Case 34-RC-2205, at 28.

9. Further, despite language in the operating agreement permitting drivers to determine their own hours and breaks, courts have placed heavier weight on the control that FedEx has over the number of packages assigned and delivery times. In particular, FedEx’s control over delivery appointments has proven to be a critical factor since specific delivery appointments make it difficult for the driver to start work later in the day, or put off some package deliveries until the following day, as he/she may desire to do. FedEx Ground Package Sys., Inc. & FXG-HD Drivers Ass’n, Case 4-RC-20974, at 15.

C. RECENT DEVELOPMENTS


   a. Plaintiffs, three FedEx drivers, argued that they should be considered employees for the limited purpose of entitlement to reimbursement given their high integration into day-to-day activities at FedEx. FedEx pointed to language found in their standard “operating agreement,” characterizing the drivers as independent contractors. It further argued that drivers get a “true entrepreneurial opportunity, depending on how well the drivers perform.” 64 Cal. Rptr. 3d at 337.

   b. The court did not find the operating agreement to be persuasive given the high level of control that FedEx regularly exercised over these workers, leaving them with little room to deviate from company-established norms. Among other things, each driver must provide his own truck that meets FedEx’s specifications, pay the cost of maintaining the truck, and wear an approved FedEx uniform. The court also found that the relationship was further defined by the company’s “ground manual” and “operating management handbook”, which set forth detailed policies and procedures to “ensure the uniform operation of FedEx terminals throughout California.” Id. at 333. FedEx supervised and trained these workers, set
their work schedules, and inspected each driver’s truck and personal appearance. If a driver failed either of these inspections, he/she was not allowed to drive. The court relied on these factors and others to find that “FedEx’s control over every exquisite detail of the drivers’ performance, including the color of their socks and the style of their hair, supports the trial court’s conclusion that the drivers are employees, not independent contractors.” Id. at 336.

c. In the final appeal in this action, the court applied the NLRB’s agency test and relied on the factors above to find that the drivers were in fact employees. Notably, the court stated that the “independent contractor” label found in the operating agreement is not dispositive, and will not be given any weight where actual conduct establishes a different relationship. Id. As a result of this holding, 209 drivers were entitled to approximately $5 million in reimbursement for the majority of their operating expenses, with the exception of the cost of their vehicles. Id. at 378-79.

2. Attorneys General from eight states sent a joint letter in June 2009 to FedEx Ground expressing concerns that its drivers may be misclassified as independent contractors.31 The letter was signed by Attorneys General of Iowa, Kentucky, Missouri, Montana, New Jersey, Ohio, Rhode Island, and Vermont.32

a. In forming a “working group,” the eight Attorneys General recognized “that efficiencies . . . for the states will best be served [by] work[ing] together,” and urged FedEx to examine and change its business model to ensure that its workers are classified properly. Additionally, the letter made clear that the Attorneys General intended to address issues related to “making the states whole for past practices.”

b. In October 2009, the Attorneys General of New York, Montana, and New Jersey advised FedEx by letter that they intended to bring litigation against its Ground unit in order “to remedy labor law violations resulting from FedEx’s continued misclassification of its drivers as independent contractors rather than employees.”33

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32 Id.
c. Because of the extent of control FedEx was purportedly exercising over its drivers, the Attorneys General concluded that the drivers were employees under relevant state laws.  

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d. Several of these attorney generals have filed claims against FedEx ground. Among them are New York, Montana, Kentucky and Massachusetts.  

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3. Furthermore, after victory in Estrada, disgruntled drivers began taking matters into their own hands and brought suits in over 40 states. FedEx removed these actions under the Class Action Fairness Act36, and consolidated them into a multi-district litigation docket slated for the North District of Indiana. The essence of the allegation is that FedEx Ground has intentionally and consistently misclassified its drivers as independent contractors.

a. In 2007, the docket included at least 56 cases to be heard in the Northern District of Indiana. In re FedEx Ground Package Sys., Inc., Employment Practices Litig., 2007 WL 3027405, at *1 (N.D. Ind. Oct. 15, 2007). They contained a wide variety of allegations, and implicated various causes of action ranging from ERISA37 claims for benefit contributions to state wage and hour claims. Id. Except for a nationwide ERISA claim and nationwide FMLA claim, all the claims were asserted on behalf of statewide classes and plead state law violations.

b. The class included “[a]ll persons who: 1) entered or will enter into a FXG Ground or FXG Home Delivery form Operating Agreement…2) drove or will drive a vehicle on a full-time basis… to provide package pick-up and delivery services pursuant to the Operating Agreement; and 3) were eligible for ERISA plan benefits, absent their mischaracterization as independent contractors.” Id. at 22.

c. A few major rulings are noted below.

i. The court certified as class actions those claims governed by the common law of agency. Then, in a massive victory for FedEx, it granted summary judgment to FedEx in connection with those certified claims in 26 states, finding plaintiffs to be independent contractors. The ruling amounts to a defeat of over 20 consolidated class actions, including actions in California, New York, and New Jersey. In Re FedEx Ground Package Sys., Inc., Employment Practices Litig., 758 F. Supp. 2d 638 (N.D. Ind. Dec. 13, 2010).

34 Id.
ii. Class certification was denied in those cases asserting federal claims governed by the economic realities test. Summary adjudication was granted to plaintiffs in a handful of these cases, while the rest were remanded to transferor courts.  

iii. No rulings have been made on more than a dozen cases filed by individual plaintiffs in several states that were transferred to the consolidated docket between 2005 and 2009. These cases have been remanded to the transferor courts.

4. Below are some other notable outcomes of FedEx litigation.

a. In re FedEx Ground Package System, Inc. Employment Practices Litigation, No. 3:05-MD-527 RM (N.D. Ind. Aug. 11, 2010) (Merger clause in operating agreements between FedEx and delivery drivers did not prevent court from considering FedEx’s policies and practices in determining whether drivers were employees or independent contractors under Kansas Wage Payment Act; court granted FedEx summary judgment on common law claims.)

b. In re FedEx Ground Package System, Inc. Employment Practices Litigation, 2010 WL 2243246 (N.D. Ind. May 28, 2010) (granting plaintiffs summary judgment on Illinois state Wage Act claims, differentiating the case from others in which uniforms weren’t required and drivers were not required to stop at company owned terminals to retrieve the packages, and noting that above all FedEx drivers represent FedEx’s interest when delivering and picking up packages.)


d. The Eighth Circuit confronted the classification issue in a slightly different context in 2010. In Huggins v. FedEx Ground Package Systems, Inc., 592 F.3d 893 (8th Cir. 2010), a negligence case arising out of a trucking accident, FedEx alleged that the negligence if its driver could not be imputed to FedEx under respondeat superior, since the driver was an independent contractor, and not an employee. The court reversed the trial court’s grant of summary judgment, finding that issues of fact existed under Missouri’s common law agency test as to the worker’s status. The court based its conclusion on evidence in the record which it believed was

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38 Estelle Pae and Beth Ross, A Brief History: In re RedEx Ground Package Systems, Inc. Employment Practices Litigation, MDL No. 1700, Case No. 3:05-md-527RM, 589-90, ABA Labor & Employment Section (Apr. 6-9, 2011).

39 Id.
sufficient to support a reasonable inference that FedEx had the right to control the driver’s performance.

e. A jury in the Superior Court of the State of Washington rendered a verdict finding FedEx Ground workers to be independent contractors and not employees.40

f. Over a dozen states are currently involved in negotiations with FedEx over its classification practices.41

5. The battle has proven costly for FedEx, in a variety of different ways.

a. In 2008, the California Unemployment Insurance Appeals Board found that FedEx owed the state over $7 million in unpaid unemployment insurance, taxes, disability and personal income taxes for its drivers for a two year period.42

b. Additionally, the IRS assessed FedEx with a $319 million judgment in unpaid taxes resulting from misclassification of 12,000 of its drivers as independent contractors. Subsequently, the IRS backed off the assessment and allowed FedEx, instead, to properly reclassify the workers as employees.43

c. Massachusetts’ Attorney General fined FedEx Ground more than $190,000 in 2007 for intentionally misclassifying 13 drivers as independent contractors rather than employees.44 The Attorney General’s office continued its investigation pending an appeal by FedEx. This investigation

40 Anfinson v. FedEx Ground Package System Inc., 2009 WL 2173106 (Wash. Super. Apr. 20, 2009), aff’d in part, denied in part, remanded by, 244 P.3d 32 (Wash. Ct. App. 2010) (Subsequent to the jury verdict, plaintiffs challenged the trial court’s jury instructions. The central issue for the liability phase was how the trial court should instruct the jury on the legal standard for whether drivers are employees or independent contractors. On review, the court found that the appropriate test for making this determination for purposes of the state law was the economic realities test. Due to several reversible errors with the jury instructions, the matter has been remanded in part.)


revealed numerous other significant underpayments to the state’s Division of Industrial Accidents, leading to a total settlement of $3 million.45

V. OTHER RECENT LITIGATION

1. Performing Artists
   a. New York courts have addressed the question whether a performer may properly be classified as an independent contractor. Generally, under the parallel provisions of the New York Unemployment Insurance Law46 and Workers’ Compensation Law,47 as long as the “performer” is engaged in performing services for a “theatre . . . or similar establishment”, the “performing artist” is be deemed an employee in New York for those purposes.
   b. In Fouchecourt v. Metropolitan Opera Association, 537 F. Supp. 2d 629 (S.D.N.Y. 2008), plaintiff, an opera singer, fell from a stage platform during one of his performances, and subsequently brought a personal injury suit against the owner/operator of the opera house, the Metropolitan Opera Association (the “Met”). Id. at 630. The parties’ contract explicitly rejected the existence of an employer-employee relationship, and indicated that Plaintiff was performing as an independent contractor. The contract also contained the following performance-related provisions: that the Met would be responsible for the design and maintenance of the set; that Plaintiff would be responsible for attending four weeks of rehearsal; that Plaintiff would perform a minimum of thirteen performances; and that Plaintiff would be available for two periods of engagement.
   c. In analyzing whether Plaintiff was an “employee” of the Met for purposes of the Workers’ Compensation Law, the District Court first looked to the statutory definition of “employee” found in Section 2(4) of the Workers’ Compensation Law, and determined that Plaintiff fit comfortably within this definition, given the fact that he was an opera singer providing services in the performing arts, coupled with the absence of any direct evidence that Plaintiff was employed by an employer also covered by the statute.
   d. Secondly, the Court reviewed the legislative history to the 1986 amendment to § 2(4), and concluded that, without regard to whether a “performer” is considered “an independent contractor for tax or other purposes,” he or she is considered an eligible “employee” for unemployment insurance and workers compensation purposes. Id. at 633-34. Indeed, the Court noted that the “statutory definition does not turn on whether a particular musician or performing artist is an employee or

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47 N.Y. Workers’ Comp. § 2(4) (2010).
independent contractor in light of the factors usually considered in making such a determination; rather, all musicians and performing artists are deemed to be ‘employees’ for these purposes.” *Id.* at 633 (internal citations omitted). In so holding, the court observed that this construction “is consistent with the legislative intent behind the statute which is to extend the availability of unemployment insurance and workers’ compensation benefits to those in the performing arts”. *Id.* at 635.

2. Insurance Agents

a. The Ninth Circuit unanimously upheld a grant of summary judgment dismissing the claims of an employee who argued that her employer had violated Title VII of the Civil Rights Act of 1964 by favoring her male counterparts. *Murray v. Principal Fin. Group Inc.*, 613 F.3d 943 (9th Cir. 2010). In agreeing with the district court, the Ninth Circuit relied on a variety of other decisions holding that “insurance agents are independent contractors and not employees for purposes of various federal employment statutes including [ERISA, the ADEA, and Title VII].” *Id.* at 944-45 (internal citations omitted).

b. Applying the *Darden* factors, it appeared that plaintiff “was free to operate [her] business as [she] sees fit without day-to-day intrusions.” *Id.* at 946. “Murray decides when and where to work, and in fact maintains her own office, where she pays rent. She schedules her own time off, and is not entitled to vacation or sick days. Also . . . Murray is paid on commission only, reports herself as self-employed to the IRS, and sells products other than those offered by Principal in limited circumstances.” *Id.*

c. The court did acknowledge a few factors in plaintiff’s case that supported a finding of employee status. For example, she received some benefits, had a long-term relationship with the defendant, possessed an at-will contract, and was subject to some minimum standards imposed by the hiring party. However, the court ultimately found that “the overall picture presented by Murray’s relationship with Principal is still one of an independent contractor rather than an employee . . . The defendants do not control the manner and means by which Murray sells their financial products.” *Id.* As such, plaintiff was not entitled to the protection of Title VII.

3. Janitors

a. In *Bulaj v. Wilmette Real Estate and Management Co., LLC*, 2010 WL 4237851 (N.D. Ill. Oct. 21, 2010), the Northern District of Illinois found that a janitor who “was an integral part of Defendants’ management business” was an employee and not an independent contractor. *Id.* at *10.

b. Plaintiff worked as a building maintenance worker at a property management firm for over 12 years. Bulaj was paid a flat bi-weekly salary for his work, which involved the upkeep and repair of all buildings managed by Wilmette. He had an extensive collection of tools, and used
special skills to fix pipes, valves, outlets, fixtures, etc. When defendants required work that was outside the scope of plaintiff’s skill set, they hired contractors, such as electricians or carpet installers, to complete the job. Id. at *2. Plaintiff’s compensation also included a rent free apartment, with a monthly lease value of $1,200. Id.

c. In examining the control exercised by Wilmette over Bulaj, the court focused on the defendants’ practice of instructing plaintiff to perform specific janitorial duties at each of three properties. The court noted that although he was not told “how” to complete the task, “the record establish[ed] that Defendants controlled the manner in which he performed his work by setting his work schedule, monitoring the quality of his work, and disciplining him when his work did not meet Defendants’ expectations. As Bulaj correctly point[ed] out, Defendants’ right to impose their expectations on Bulaj and terminate him when he failed to meet those expectations is indicative of the fact that they controlled the manner of his work.” Id. at *6.

d. On the issue of whether his work was integral to Wilmette’s business, the judge found Bulaj’s responsibilities to be essential to the company’s operations, noting that Wilmette would most certainly lose customers if its buildings fell into disrepair as a result of Bulaj’s underperformance. Id. at *10.

VI. RECENT DEVELOPMENTS AIMED AT CURTAILING MISCLASSIFICATION

Until recently, federal and state agencies have independently and separately confronted employers that have misclassified their workers as independent contractors. However, as both the federal and state governments struggle with revenue shortfalls, various departments and agencies have started cooperating with one another to curtail worker misclassification in an effort to fill revenue gaps. Federal and state agencies have increased their enforcement efforts with respect to employers that have improperly classified their workers as independent contractors, as has the plaintiffs’ bar. Several states have formed task forces focusing on the classification issue. Other states have passed new legislation designed to curtail purported worker misclassification. Companies that are found to have improperly classified their workers are at serious risk of significant assessments by federal and state agencies, various penalties, and class action litigation. This greater coordination and collaboration between (and within) federal and state agencies has resulted in the discovery of numerous violations and the assessment and recovery of large sums of tax revenues. Below is a description of some of these efforts.
A. THE FEDERAL CAMPAIGN AGAINST MISCLASSIFICATION

1. IRS National Research Program Audits
   a. A 2009 report by the GAO estimated that misclassification cost the federal government approximately $1.6 billion in revenue in 2006.48
      i. This estimate was based on outdated data reported by the IRS in 1984, which found that 15 percent of employers misclassified their workers. Id. However, these numbers substantially increased over the years. From 2000 to 2007, the number of misclassified workers based on state audits increased from approximately 106,000 to over 150,000. Id.
      ii. Further, a 2009 report by the Treasury Inspector General for Tax Administration places the IRS’ most recent estimates of the costs of misclassification at $54 billion in employment tax, and $15 billion in unpaid FICA and UI taxes.49
   b. In November 2009, the IRS announced that it would be commencing a nationwide audit of 6,000 randomly-selected companies to determine, among other potential tax violations, whether all employment taxes are properly accounted for and paid.50
   c. The initiative will span three years, with approximately 2,000 “National Research Program” audits occurring annually. The IRS will be training about 300 agents to conduct face-to-face interviews, and line by line reviews of employers’ employment tax returns, focusing on 2007 and 2008.51
   d. The audits, which began in February 2010, covers employers of all sizes and types, including non-profit organizations.52

51 The HR Specialist, Contractor or employee? IRS launches audit blitz, Business Management Daily (Jan. 15, 2010), http://www.businessmanagementdaily.com/articles/21053/1/Contractor-or-employee-IRS-launches-audit-blitz/Page1.html (last access Aug. 16, 2011).
e. Given its impact on lost revenue, misclassification will be the primary focus of the audits. These audits will determine, among other things, the number of employers that misclassify workers, the number of independent contractors who are misclassified, and the resulting loss on tax revenue. On this front, the IRS will rely on various data sources such as information from 1099 and W2 filings, as well as payroll records, plan documents, invoices, and expense reimbursement policies.

i. The IRS has also identified other areas requiring scrutiny, including fringe benefits, nonfilers, executive compensation and employee expense reimbursement.

f. The IRS will utilize data obtained from its audits to target areas for the highest potential for non-compliance.

2. Labor and Treasury Department Misclassification Initiative

a. As part of the federal budget for fiscal year 2011, the Obama Administration allocated nearly $25 million to a worker misclassification initiative to be carried out by the Labor and Treasury Departments in targeting employers that have improperly classified workers as independent contractors rather than as employees. The initiative provides for 100 additional enforcement personnel and competitive grants to both incentivize and prepare states to assist in addressing the problem.


3. Cooperation with state governments
   
a. In August 2009, the GAO issued a report titled “Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention” (“2009 GAO Report”) – which discussed the extent of worker misclassification, the steps taken thus far by U.S. DOL and the IRS to ensure compliance with labor and tax laws and regulations, and recommendations for increasing collaboration between those agencies and compliance by businesses with respect to the proper classification of workers.58
   
b. According to this report, at least 12 states have some type of agreement with the U.S. DOL to work collaboratively to identify worker misclassification.59 Additionally, 34 state agencies share information with the IRS on misclassification as part of the IRS’s Questionable Employment Tax Practices (“QETP”) initiative, which has been in place since 2005 to identify unlawful employment tax practices and to increase voluntary compliance with employment tax rules and regulations.60
   
c. The report was critical over the U.S. DOL’s efforts to “clamp-down” on worker misclassification.

VII. PROPOSED LEGISLATION
   
   A. In April, 2010, Rep. Lynn Woolsey, D-Calif., and Sen. Sherrod Brown, D-Ohio introduced identical bills aimed at targeting abuses of improper worker classification.61 The bills, entitled “Employee Misclassification Prevention Act” acknowledge that employees may refrain from challenging misclassification out of fear of retaliation or impact on future career prospects. Deputy Secretary of Labor, Seth Harris strongly backed this legislation, stating that he viewed it as “a critically important legislative vehicle for addressing worker misclassification.”62 If passed, the bills would amend the FLSA to require employers to maintain records relating to employee status, and to inform both employees and independent contractors of their rights to proper classification under federal laws. Furthermore, businesses found to be in violation of the law would be subject to civil penalties of up to $1,100, or $5,000 for willful violations.

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59 See id. at 29.
60 See id. at 30-31.
B. This is not the first legislative attempt at solving the misclassification problem— in 2009, Rep. James McDermott, D-Wash. introduced a bill in the House of Representatives seeking to amend the Internal Revenue Code of 1986 “to modify the rules relating to the treatment of individuals as independent contractors or employees.” In particular, the bill would also restrict employer reliance on Section 530 of the Code, which currently contains a safe-harbor provision allowing employer to avoid tax penalties for some misclassifications.

1. In 2007, the Independent Contractor Proper Classification Act of 2007 was introduced with similar requirements. This bill seeks to disallow employers to use industry practice as a reasonable basis for not treating a worker as an employee.

VIII. STATES TARGET THE MISCLASSIFICATION PROBLEM

A. Several state legislatures have enacted laws seeking to curtail misclassification. Some typical provisions appear below.

1. Massachusetts Independent Contractor Law

   a. Massachusetts has one of the strictest laws on the classification of independent contractors. Creating a strong (rebuttable) presumption that a worker is an employee rather than an independent contractor, the Massachusetts Independent Contractor Law (“MICL”) places the burden of proving otherwise on the employer. Mass. Gen. Laws ch. 149, § 148B (2004).

   b. The MICL outlines a rigorous three-part test (also known as the “ABC test”), and requires that all of the following factors must be satisfied in order for an individual to be classified other than as an employee: (A) the individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact; and (B) the service is performed outside the usual course of the business of the employer; and (C) the individual is customarily engaged in an independently established trade, occupation,

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63 H.R. 3408, 111th Cong. (2009) (Referred to House Comm. on Ways and Means.)
65 S. 2044, 110th Cong. (2007.) (Referred to Comm. on Finance.)

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profession or business of the same nature as that involved in the service performed. *Id.*

c. In *Somers v. Converged Access, Inc.*, 454 Mass. 582, 590-91 (Mass. 2009), the Massachusetts Supreme Court held the MICL is a strict liability statute and, therefore, the employer’s intent when misclassifying an employee is irrelevant. The court stated “[g]ood faith or bad, if an employer misclassifies an employee as an independent contractor, the employer must suffer the consequences.” *Id.* In that case, the plaintiff, who worked on a temporary basis for the employer and applied unsuccessfully for permanent positions, filed an action against the employer alleging violation of the MICL. *Id.* The Superior Court granted the employer’s motion for summary judgment and the plaintiff appealed. The employer argued that the plaintiff was paid more as an independent contractor than he would have been paid as an employee, even when the value of his benefits and his overtime pay was calculated. As such, the employer argued that there were no damages. Rejecting the employer’s damages argument, the court held that the employee’s damages were equal to the value of wages and benefits he should have received as an employee, but did not. *Id.* at 744. The court then reversed summary judgment in favor of the employer, and held that the issue at trial “will be whether the plaintiff was properly classified as an independent contractor under G.L. c. 149, § 148B.” *Id.* If the defendant/employer is unsuccessful on remand, the plaintiff “will be entitled . . . to damages incurred, including treble damages for any lost wages and other benefits. The damages incurred will include any wages and benefits the plaintiff proves he was denied because of his misclassification as an independent contractor, including the holiday pay, vacation pay, and other benefits that he would have been entitled to as [an] . . . employee.” *Id.* at 751 (quotations omitted).

2. Like Massachusetts, Illinois’ Employee Classification Act creates a rebuttable presumption of employment. An employer who has misclassified an employee may face civil penalties of up to $1,500 and $2,500 for each repeat violation.68 Further, in egregious cases, the employer may be subject to debarment from state contracts for four years and may face criminal penalties.69 The aggrieved employee may also sue for compensatory damages of up to $500 per violation, exclusive of fees and costs.70

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67 See Rainbow Development, LLC v. Mass. Dept. of Industrial Accidents, 2005 WL 3543770, at *1 (Mass. Super. 2005), for a general application of the MICL. In that case, the Massachusetts Superior Court applied the MICL and determined that workers at an “auto detailing” establishment were not independent contractors because, in significant part, they performed all the work for the business, were supervised, and did not carry their own liability insurance.

68 820 Ill. Comp. Stat. 185/40

69 820 Ill. Comp. Stat. 185/42

70 820 Ill. Comp. Stat. 185/60. Note, however, that the Illinois Classification Act is currently being challenged by a contractor on constitutional grounds in the Illinois state court. See Bartlow v. Shannon, 927 N.E.2d 88 (Ill. App. Ct.) (holding that plaintiff contractors raised a fair question as to whether Act violated their procedural due process rights and that action was ripe for decision), *appeal denied*, 938 N.E.2d 518 (Ill. 2010).
3. In New Jersey, the Construction Industry Independent Contractor Act ("CIICA") creates a rebuttable presumption that full-time construction workers are employees, and not independent contractors, for purposes of various New Jersey labor and employment-related laws.\(^{71}\) If a contractor is found to have violated the CIICA, penalties include suspension of the contractor’s registration, a “stop-work” order, and a civil fine of up to $2,500 for the first violation and $5,000 for each subsequent violation. \(\text{Id.}\)

4. Minnesota has also experimented with the concept of a presumption of employment. In response to a study commissioned by its Legislative Audit Commission, the Minnesota legislature passed a law requiring all independent contractors working in the construction industry to secure an exemption certificate from the Department of Labor and Industry, and imposing a penalty of up to $5,000 for each violation. This legislation created a presumption of employment, in which a worker is presumed to be an employee if no exemption certificate had been issued.\(^{72}\)

5. The New York legislature has taken a more targeted approach to the misclassification problem, focusing its efforts on those industries that are known to be riddled with violations, while also shifting to employers, generally, certain “notice” obligations which have the purpose and effect of requiring businesses to make informed decisions as to how they classify workers.

   a. The New York legislature has passed a law that articulates clear guidelines to determine when livery cab drivers in New York City, Westchester, and Nassau Counties are to be considered independent contractors.\(^{73}\)

   b. Another recently passed law, the New York State Construction Industry Fair Play Act, aims to correct misclassification in the construction industry. The Act amends New York’s Labor Law to create a rebuttable presumption that all construction workers are employees. Additionally, the Act amends the state’s Unemployment Insurance Law and Workers’ Compensation Law, incorporating that presumption into each. The Act follows recent studies revealing that nearly one in four construction workers are either misclassified or completely “off the books”.\(^{74}\)

   c. In 2010, New York passed the New York State Wage Theft Prevention Act, amending several provisions in the New York Labor Law, by imposing stringent pay notice requirements on employers who will have to advise all new hires and their existing employees annually, in writing, both in English and the language identified by the employee as his or her primary language, how the employee is paid, e.g., salary or hourly, shift, day, week, overtime rate, commission, etc. Similarly, the Act also requires

\[^{71}\text{See N.J.S. 34:20-1 to 34:20-11.}\]
\[^{73}\text{N.Y. Workers’ Comp. Law § 18-c.}\]
\[^{74}\text{N.Y. Lab. Law § 861.}\]
employers to furnish employees with a statement every pay period identifying the employee’s pay rate, overtime rate, overtime earnings, amount of gross wages, deductions, and net wages paid.

As a result of having to meet these notice requirements, employers will be prompted to undertake investigations of their employees’ current classifications, and will accordingly be deemed “on notice” of any misclassifications. As such, any future misclassifications will be considered “willful violations”, and will subject employers to heightened penalties. The Act provides that where a wage violation is found to be “willful”, the employer may be liable for liquidated damages of 100 percent of the wages due. The Act also strengthens criminal penalties against employers for violations of New York’s wage laws, inclusive of the new notice requirements.

6. The state of Wisconsin has enacted similar legislation. In May 2010, the Governor of Wisconsin signed two bills regarding classification. The first, Senate Bill 672 requires the Department of Workforce Development ("DWD") to establish a system to ensure proper classification of workers under a variety of the states employment laws. The DWD is charged to educate employers, employees, and the public about proper classification. It also authorizes the DWD to require an employer to provide wage and hour records. Assembly Bill 929 is specific to those employers engaged in the painting or drywall finishing of buildings or other structures who willfully misclassify employees. These bills were enacted together as one law. Now effective, it provides for a hefty $25,000 penalty for each violation.75

B. INTERAGENCY TASK FORCES

1. Recently, interagency and joint “task forces” have been established in several states to combat the gaps and deficiencies resulting from uncoordinated investigations and audits of misclassification. Generally, these task forces have been charged with sharing information between the relevant administrative authorities concerning employers who are suspected of improperly classifying workers, pooling investigative and enforcement resources, developing strategies for systemic investigations of misclassification practices, increasing public awareness of the harms resulting from worker misclassifications, creating hotlines for the public to report wage violations, and referring cases to prosecuting authorities as appropriate.

2. New York, California, Connecticut, Iowa, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Hampshire, New Jersey, Oregon, Rhode Island, Utah, Vermont, and Wisconsin have all established such task forces, either through legislation, or internal collaboration.76 Other states have launched their own investigations. Highlights of states’ findings appear below.

75 Wis. Stat. Ann. § 103.06.
a. During the 16 months between its formation and the issuance of the Annual Report, the New York Task Force identified 12,300 instances of worker misclassification and discovered $157 million in unreported wages. Moreover, its multi-agency approach has led to the recovery of $4.8 million in unemployment taxes, more than $12 million in unpaid wages, and more than $1.1 million in workers’ compensation fines and penalties.77

i. New York’s most recent 2011 Annual Report boasts discovery of over $314 million in unreported wages, and assessment of over $10.5 million in unemployment taxes, $2 million in unpaid wages and over $800,000 in workers’ compensation fines and penalties in the year 2010.78

ii. Additionally, the New York Industrial Board of Appeals found that drivers of a limousine service were employees based on the “right to control”.79

b. In March 2009, New York’s Attorney General Andrew M. Cuomo announced the first arrest stemming from a NY Task Force “sweep” of employers suspected of misclassifying workers.80

i. Charged with several felonies and misdemeanors in criminal court, the owner of a bakery in Bronx, New York, allegedly violated labor laws by, among others, failing to pay unemployment insurance taxes and failing to pay over $350,000 in wages to employees.81

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According to the complaint filed, the bakery owner failed to pay the minimum wage to at least 25 workers, while requiring them to work up to 80 hours a week with no overtime pay.\textsuperscript{82}

ii. In a second arrest, Attorney General Cuomo charged a Bronx-based gas station owner with failure to pay more than $225,000 in wages, failure to pay into the state’s unemployment insurance system, and failure to cover workers with Workers’ Compensation insurance.\textsuperscript{83} The complaint, filed in criminal court, alleged that the gas station owner paid his employees as little as $4.00 per hour for working 12-hour days, with no overtime, and failed to secure workers’ compensation insurance for his employees, which is a felony offense in New York.\textsuperscript{84}

c. According to the 2010 annual report of the Massachusetts Joint Enforcement Task Force on the Underground Economy and Employee Misclassification, member agency investigations recouped $6,489,549. This figure represents an increase of $5,050,525 from the prior year’s recovery of $1,439,024.\textsuperscript{85}

d. An Indiana state study of 2007 and 2008 audit records places annual losses at an estimated $268 million. Further, nearly 47.5 percent of audited employers had misclassified employees as independent contractors. The analysis estimated that nearly 420,000 employees statewide may be affected by misclassification.\textsuperscript{86}

e. About 40 percent of all employers audited by the state of New Jersey were found to have misclassified workers as independent contractors, according to a 2007 study.\textsuperscript{87}

f. Similarly, the Wisconsin Unemployment Insurance Division found that 44 percent of the workers investigated in the course of employer audits had been misclassified.\textsuperscript{88}

\textsuperscript{82} Id.
\textsuperscript{83} Id.
\textsuperscript{84} Id.
g. A 2009 report by the Ohio Attorney General estimated that up to 459,000 workers were misclassified each year. It also found that the state lost up to $100 million in unemployment compensation payments, up to $510 million in workers compensation premiums and up to $248 million in forgone state incomes tax revenues.  

h. In California, nearly $7 billion in tax revenue is estimated to have been lost due to misclassification.

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88 Report of the Worker Misclassification Task Force, Submitted to Secretary Roberta Gassman, Wisconsin Department of Workforce Development (June 2009).
