

**MISCLASSIFYING WORKERS AS INDEPENDENT CONTRACTORS:  
THE PRICE OF INDEPENDENCE**

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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 employers to not only understand the law and its implications, but to also develop innovative defenses against these suits. Counsel for employers must also craft effective settlement strategies to minimize the time and expense of litigation.

**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, which represented 7.4% of the workforce.<sup>1</sup>

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<sup>1</sup> *Contingent and Alternative Employment Arrangements February 2005*, U.S. Dept. of Labor, Bureau of Labor Statistics, July 27, 2005, available at <http://www.bls.gov/news.release/conemp.nr0.htm> (last visited on March 21, 2010).

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% of employers had misclassified 3.4 million workers as independent contractors in tax year 1984.<sup>2</sup>

### 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. The Government Accountability Office (“GAO”) has estimated that worker misclassification costs the federal treasury \$4.7 billion annually in income tax revenues.<sup>3</sup>
  - c. 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.<sup>4</sup>
  - d. In California, nearly \$7 billion in tax revenues is estimated to have been lost due to misclassification.<sup>5</sup>
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.

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<sup>2</sup> *Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention*, United States Gov’t Accountability Office Report of Congressional Requestors, Aug. 2009, at 10, available at <http://www.gao.gov/new.items/d09717.pdf> (last visited on March 21, 2010).

<sup>3</sup> *Rep. McDermott Leads Legislative Drive to End Misclassification of Workers*, Apr. 15, 2008, available at <http://www.house.gov/mcdermott/pr080415.shtml> (last visited on March 21, 2010).

<sup>4</sup> *See id.* at 12.

<sup>5</sup> *See* Linda H. Donahue, James Ryan Lamare, and Fred B. Kotler, J.D., *The Cost of Worker Misclassification in New York State*, Cornell University ILR School, Research Studies and Reports, 2007, at 11, available at <http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1009&context=reports> (last visited on March 21, 2010) (citing Jerome Horton, California State Assembly Member, 51st Assembly District, recorded interview within *1099 Misclassification: It’s Time to Play by the Rules*, video stream currently available at [http://www.mosaicprint.com/client\\_preview/1099/index.html#](http://www.mosaicprint.com/client_preview/1099/index.html#)) (last visited on March 21, 2010).

- 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 businesses that misclassify their workers as independent contractors. *See infra* at Section IV.D.

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

While the line between an “employee” and an “independent contractor” may be muddled at times, as demonstrated in detail below, companies have increasingly taken the business risk to maintain the independent contractor status of their 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. N.L.R.B.*, 60 F.3d 855, 857-858 (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, if not most, 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, expressly 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 law. Recently, 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).<sup>6</sup>

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<sup>6</sup> 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

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. In this regard, employees present another “liability” for employers to consider.

## **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.

### **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”

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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.

- 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.” *N.L.R.B. 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. *N.L.R.B. v. Associated Diamond Cabs, Inc.*, 702 F.2d 912 (11th Cir. 1983) (citing *N.L.R.B. 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. *N.L.R.B. v. Gary Enterprises*, 1992 U.S. App. LEXIS 5538 (4th Cir. 1992) (citing *Air Transit, Inc., v. N.L.R.B.*, 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;<sup>7</sup>
- 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;

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<sup>7</sup> See, *e.g.*, *Lerohl v. Friends of Minnesota Sinfonia*, 322 F.3d 486, 489 (8th Cir. 2003) (applying “right to control” test to professional musicians).

- 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).
- c. Employment status under the NLRA is dependent upon common law principles of agency. Common law agency principles require an analysis of the "right to control." *See Dial-A-Mattress Operating Corp.*, 326 N.L.R.B. No. 75 (1998); *NLRB v. United Ins. Co. of Am.*, 390 U.S. 254, 256 (1968).
  - 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, use the right to control test. Misclassifying an employee for benefit purposes can result in significant liability.
- b. An “employee,” for purposes of ERISA, is defined as “any individual employed by an employer.” 29 U.S.C. § 1002(6) (2000).
- c. *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318 (1992)
  - 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), *reh’g en banc granted*, 105 F.3d 1334 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998), 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 Savings Plus Plan (“SPP”) benefits and stock-option benefits under an Employee Stock Purchase Plan (“ESPP”).
- 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 to deny 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. To determine if a worker is an employee, use the right to control test. Misclassifying an employee for tax purposes can have significant liability.
- c. Under the Code, 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.
- d. 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).
- e. 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.
- f. 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.
- g. 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.
- h. 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.
- i. 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.”
- j. 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.
- k. 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. Taxpayer Responsibility Accountability, and Consistency Act of 2009

- a. In December 2009, Senator John Kerry, D-Mass, introduced the Taxpayer Responsibility, Accountability and Consistency Act of 2009 (“TRACA”) to close the safe harbor created by Section 530.<sup>8</sup> If enacted, the TRACA would, among other things, change the safe harbor provision to minimize abuses and require companies that pay more than \$600 a year to providers of property and services to file an information report with each provider *and* with the IRS.

#### 7. 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 employee 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 (N.Y. Ct. App. 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;

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<sup>8</sup> See *Taxpayer Responsibility Accountability, and Consistency Act of 2009*, S. 2882, 111th Cong. 2009, available at <http://www.govtrack.us/congress/bill.xpd?bill=s111-2882> (last visited on March 21, 2010).

- 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. In California, *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;

- 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.
- e. Moreover, in *Arruda v. Gold Crest Kitchens*, 1994 Fla. App. LEXIS 8784 (1994), the court stated that the definition of an employee was amended to include sole proprietors actively engaged in the construction industry “unless they elect to be excluded from the definition of employee by filing written notice of the election with the division.” *Id.*; see also *Fla. Dep't of Fin. Servs. v. MJ Versaggi Trust*, 952 So. 2d 583, 586 (Fla. Dist. Ct. App. 2d Dist. 2007).
- f. In New York, *Leone v. United States of America*, 910 F.2d 46 (2d Cir. 1990), cert. denied, 499 U.S. 905, 111 S. Ct. 1103 (1991), sets forth the factors to be 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.<sup>9</sup>
- g. Courts generally focus on the amount of control a business exerts over a worker. More specifically, 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 Florida, Inc. v. State of Florida, Division of Unemployment Compensation*, 779 So. 2d 663

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<sup>9</sup> See also *Fraser v. U.S.*, 490 F.Supp.2d 302, 310 (E.D.N.Y. 2007) (applying the *Leone* factors to determine if construction worker is an independent contractor).

(Fla. 3d DCA 2001); *Carroll v. Federal Express Corporation*, 1995 U.S. Dist. Lexis 12026 (N.D. Cal. 1995); *In re Polinsky*, 163 A.D. 2d 684 (N.Y. App. Div 3d Dept. 1990).

- h. 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).
- i. 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. Medical, 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'").
- j. 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.<sup>10</sup>
- k. 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,

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<sup>10</sup> *See Unemployment Compensation Employer Handbook*, Florida Department of Revenue, available at [https://taxlaw.state.fl.us/uct\\_ehb.aspx?file=uct\\_ehb](https://taxlaw.state.fl.us/uct_ehb.aspx?file=uct_ehb) (last visited on March 21, 2010).

determines employment status.<sup>11</sup>

1. The New York Department of Labor has also issued legal guidance on factors indicating an employment relationship versus an independent contractor relationship in the context of unemployment insurance.<sup>12</sup> Factors weighing in favor of an employment relationship include:
  - 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;

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<sup>11</sup> *See id.*

<sup>12</sup> *See Unemployment Insurance*, New York Department of Labor, available at <http://www.labor.state.ny.us/ui/PDFs/ia31814.pdf> (last accessed 3/7/2010).

- xiii. Services performed are an integral part of the business, particularly when performed on a continuing basis;<sup>13</sup>
  - 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;
  - 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.
- m. 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.

## **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

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<sup>13</sup> 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.”

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),<sup>14</sup> 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.

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

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<sup>14</sup> 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*).

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).
- c. Under the FLSA, “common law employee categories or employer-employee classifications under other statutes are not of controlling significance.” *Walling v. Portland Terminal Co.*, 330 U.S. 148, 150, 153 (1947). Rather, “the *economic reality* rather than technical concepts is ... the test of employment” under the FLSA. *Goldberg v. Whitaker House Coop., Inc.*, 366 U.S. 28, 32-33 (1961).

### 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.”<sup>15</sup>
- 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)

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<sup>15</sup> See *FLSA Coverage – Employment Relationship, Statutory Exclusions, Geographical Limits*, DOL, Wage & Hour Division, Field Operations Handbook, Oct. 20, 1993, § 10b11, available at [http://www.dol.gov/whd/FOH/FOH\\_Ch10.pdf](http://www.dol.gov/whd/FOH/FOH_Ch10.pdf) (last visited on March 21, 2010).

the employer that provides the training derives no immediate 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. Irrespective of how an individual is described – intern, trainee, apprentice, extern or volunteer – the ultimate inquiry, under federal law, 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).

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, that 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 p. 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 and 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.<sup>16</sup>

4. *Hallissey v. America Online, Inc.*, 2006 U.S. Dist. LEXIS 12964 (S.D.N.Y. Mar. 10, 2006)
  - 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.<sup>17</sup> 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

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<sup>16</sup> *See also* Wage and Hour Opinion Letter, No. 1422 (WH-369) (December 3, 1975).

<sup>17</sup> In June 2001, a related case, *Williams, et al. v. Am. Online Inc., et al.*, 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.

“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 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.
- g. In February 2008, the court granted plaintiffs’ motion to conditionally certify a nationwide FLSA class and to issue notice. *Hallsisey v. Am. Online, Inc.*, 2008 U.S. Dist. LEXIS at \*13 (S.D.N.Y. Feb. 19, 2008).

- h. In December 2009, the parties filed a joint application for preliminary approval of settlement and notice to class. AOL agreed to settle the lawsuit for \$15 million, including attorneys' fees and costs. The court is expected to rule on the proposed settlement in April of 2010.

## 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. Some courts use only the right to control test.

### 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 Community Supervision and Corrections Dept.*, 479 F.3d 377, 380 (5th Cir. 2007); *West-Anderson v. Choicepoint Services, Inc.*, 65 Fed. Appx. 246, 247 (10th Cir. 2003); *Speen v. Crown Clothing Corp.*, 102 F.3d 625, 630 (1st Cir. 1996), *cert. denied*, 520 U.S. 1276, 117 S. Ct. 2457 (1997). 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;
  - 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. *Ahlmeyer v. Nevada System 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, the common law agency test is largely indistinguishable from the hybrid approach. Generally, courts would 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.), *cert. denied*, 515 U.S. 1159 (1995); *Barnhart v. New York Life Insurance Company*, 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.<sup>18</sup> *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), *cert. denied*, 459 U.S. 874 (1982).
- c. In *People of the State of New York v. Holiday Inns*, 1993 U.S. Dist. LEXIS 1301 (W.D.N.Y. 1993) the court stated, in "Title VII cases, courts should utilize a combination of the 'economic realities test' and the 'common law right of control test.'" *See, e.g., Brown v. J. Kaz, Inc.*, 581 F.3d 175, 180 n. 2 (3d Cir. 2009); *Cornish v. Texas Dep't of Criminal Justice*, 2006 WL 509416, at \*6 (N.D. Tex. Mar. 2, 2006); *Oestman v. Nat'l Farmers Union Ins. Co.*, 958 F.2d 303 (10th Cir. 1992); *Diggs v. Harris Hospital-Methodist, Inc.*, 847 F.2d 270 (5th Cir. 1988), *cert. denied*, 488 U.S. 956, 109 S. Ct. 394 (1988); *Unger v. Consolidated Foods Corporations*, 657 F.2d 909 (7th Cir. 1981), *vacated on other grounds*, 456 U.S. 1002, 102 S. Ct. 2288 (1982); *Spirides v. Reinhardt*, 198 U.S. App. D.C. 93 (D.C. Cir. 1979).
- d. 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

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<sup>18</sup> 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).

one act.” *Cobb*, 673 F.2d 337, 340. *See, e.g. Knight v. United Farm Bureau Mutual Insurance Company*, 950 F.2d 377 (7th Cir. 1991).

- e. 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)).
- f. 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.”).<sup>19</sup>

#### 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 Services, 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 Minnesota Sinfonia*, 181 F. Supp. 2d 1003

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<sup>19</sup> 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), *cert. denied*, 520 U.S. 1248 (1997). 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”).

(D. Minn. 2002), *cert. denied*, 540 U.S. 983, 124 S. Ct. 469 (2003) (using the hybrid test to determine whether the hired person was actually an employee or an 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.<sup>20</sup> 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.<sup>21</sup>
- 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.”<sup>22</sup>

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

1. The D.C. Circuit Court of Appeals has recently applied a new “entrepreneurial test” to determine independent contractor status under the National Labor Relations Act (“NLRA”). *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

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<sup>20</sup> See EEOC Notice Number 915.002, available at <http://www.eeoc.gov/policy/docs/conting.html> (last visited March 21, 2010).

<sup>21</sup> *Id.*

<sup>22</sup> John Bruntz, *The Employee/Independent Contractor Dichotomy: A Rose Is Not Always A Rose*, 8 Hofstra Lab. L.J. 337, 360 (1991).

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.” *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.” *Id.* at 497. The court determined that its decision in *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.” *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. *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). *Id.* at 500-501. Likewise, the failure of some drivers to take advantage of the entrepreneurial opportunities available to them is irrelevant to the inquiry of whether they can be termed “employees.” *Id.* at 502.
5. Though the court took pains to state that it had examined the case under the factors of the traditional right-of-control test, it explained that an “entrepreneurial opportunity” is the most important consideration of all. *Id.* at 497. The court concluded that, taking into account all of the factors, a finding of independent contractor status was warranted. *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 held in high esteem by other courts.

#### **IV. RECENT DEVELOPMENTS IN ENFORCEMENT OF LABOR AND EMPLOYMENT LAWS COMMONLY ASSOCIATED WITH MISCLASSIFICATION**

As the federal government and state governments struggle with revenue shortfalls, they have increased enforcement in the area of worker misclassification in an effort to fill revenue gaps. Federal and state agencies have increased their enforcement efforts with respect to employers that allegedly have improperly classified their workers as independent contractors, while plaintiffs' attorneys have targeted employers that wrongly classify personnel as exempt employees. Several states have formed task forces to focus 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. Below is a description of some of these developments.

##### **A. FEDERAL AND STATE JOINT COORDINATION EFFORTS**

1. Until recently, federal and state agencies have independently and separately confronted employers that have misclassified their workers as independent contractors. In the past several years, however, greater coordination and collaboration between (and within) federal and state agencies have resulted in the discovery of numerous violations and the assessment and recovery of large sums of tax revenues.
2. In August 2009, the Government Accountability Office ("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.<sup>23</sup>
3. According to the 2009 GAO Report, at least 12 states have some type of agreement with the U.S. DOL to work collaboratively to identify worker misclassification.<sup>24</sup> 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.<sup>25</sup>

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<sup>23</sup> *Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention*, Aug. 9, 2009, available at <http://www.gao.gov/products/GAO-09-717> (last visited March 21, 2010).

<sup>24</sup> *See id.* at 29.

<sup>25</sup> *See id.* at 30-31.

4. In November 2009, the IRS announced that it will commence 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.<sup>26</sup> This audit will examine the number of employers that misclassify workers, the number of independent contractors who are misclassified, and the resulting loss on tax revenue.<sup>27</sup>
5. The Obama Administration announced that, in the proposed federal budget for fiscal year 2011, nearly \$25 million has been directed to a worker misclassification initiative to be carried out by the Labor and Treasury Departments to target employers that have improperly classified workers as independent contractors rather than as employees.<sup>28</sup>

## **B. STATES TARGET THE MISCLASSIFICATION PROBLEM**

1. State legislators have enacted laws in Colorado [Colo. Rev. Stat. § 8-70-115(b)], Connecticut [Conn. Gen. Stat. § 31-222(a)(1)(B)(ii)], Illinois [820 ILCS 185/1-999], Louisiana [La. R.S. 23:1021], Maryland [Maryland Gen. Stat. 9-402.1], Massachusetts [Mass. Gen. Laws ch. 149, § 148B (2004)], New Hampshire [RSA 281-A:2], New Jersey [N.J.S.A. 34:20-1 to 34:20-11], and New Mexico [N.M. Gen. Stat. § 51-1-42] to impose harsher penalties associated with, and to curtail the pervasive problem of, worker misclassification.
2. 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

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<sup>26</sup> Ryan J. Donmoyer, *IRS to Audit 6,000 Companies to Test Employment Tax Compliance*, Sept. 18, 2009, available at <http://www.bloomberg.com/apps/news?pid=20601103&sid=anpR2t09GIeU> (last visited on March 21, 2010).

<sup>27</sup> *IRS Will Begin Employment Tax Research Study in February 2010*, Headliner Volume 280, November 9, 2009, available at <http://www.irs.gov/businesses/small/article/0,,id=215350,00.html> (last -visited on March 21, 2010).

<sup>28</sup> Abigail Rubenstein, *Obama Allots \$25M For DOL To Fight Misclassification*, available at <http://www.law360.com/articles/146861> (last visited on March 21, 2010); *DOL Requests \$117 Billion for FY 2011, Including \$14 Billion in Discretionary Funding*, 20 Daily Lab. Rep. (BNA) AA-2 (Feb. 2, 2010).

independently established trade, occupation, profession or business of the same nature as that involved in the service performed. *Id.*<sup>29</sup>

- c. In *Somers v. Converged Access, Inc.*, 454 Mass. 582, 590-591 (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).
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. *See* P.L. 2007, c.114, codified at N.J.S. 34:20-1 to 34:20-11. 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. *Id.*

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<sup>29</sup> *See Rainbow Development, LLC v. Com., 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.

4. Laws similar to the MICL and the CIICA have been enacted in other states, including Illinois, Washington, and New Hampshire.

### C. 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, Connecticut, Iowa, Maine, Maryland, Massachusetts, Michigan, New Hampshire, Vermont, and Wisconsin have all established such task forces.<sup>30</sup> In its 2009 Annual Report, the New York Joint Enforcement Task Force on Employee Misclassification (“NY Task Force”) reported the results of unprecedented coordination between the six agencies involved in the enforcement of workplace-related laws.<sup>31</sup>
3. During the 16 months between its formation and the issuance of the Annual Report, the NY 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.  
*Id.*

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<sup>30</sup> Diane Weaver Dunne, *State Recommits To Fighting Shadow Labor*, Hartford Business Journal Online, Oct. 19, 2009, available at <http://www.hartfordbusiness.com/news10616.html#> (last visited on March 21, 2010); *Worker Misclassification Task Force*, Maine Dept. of Labor, Jan. 14, 2009, available at <http://www.maine.gov/labor/misclass/index.shtml> (last visited on March 21, 2010); *The Joint Enforcement Task Force on Workplace Fraud, Executive Order*, The State of Maryland Executive Department, Jan. 1, 2009, available at <http://www.gov.state.md.us/executiveorders/01.01.2009%2009.pdf> (last visited on March 21, 2010); *Establishing a Joint Enforcement Task Force on the Underground Economy and Employee Misclassification, Executive Order No. 499*, March 12, 2008, available at [http://www.mass.gov/Agov3/docs/Executive%20Orders/executive\\_order\\_499.pdf](http://www.mass.gov/Agov3/docs/Executive%20Orders/executive_order_499.pdf) (last visited on March 21, 2010); *Employee Misclassification Task Force*, Dep’t of Energy Labor & Economic Growth, available at <http://www.michigan.gov/dleg/0,1607,7-154-11122-211291--,00.html> (last visited on March 21, 2010); *Task Force For The Misclassification of NH Workers*, available at <http://www.nh.gov/nhworkers/> (last visited on March 21, 2010).

<sup>31</sup> *Annual Report of the Joint Enforcement Task Force on Employee Misclassification*, Feb. 1, 2009, at 3, available at [http://www.labor.state.ny.us/agencyinfo/PDFs/Misclassification\\_TaskForce\\_AnnualRpt\\_2008.pdf](http://www.labor.state.ny.us/agencyinfo/PDFs/Misclassification_TaskForce_AnnualRpt_2008.pdf) (last visited on March 21, 2010).

## D. CRIMINAL PROSECUTIONS

1. 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.<sup>32</sup>
2. 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.<sup>33</sup> 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.<sup>34</sup>
3. 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.<sup>35</sup> 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.<sup>36</sup>

## V. LITIGATION AND SETTLEMENTS

### A. COSTLY SETTLEMENTS

1. In addition to the recent proposed settlement between America Online and its Community Leader volunteers (*see supra* at Section IV(B)(4)), other large organizations have opted to pay out expensive settlements rather than litigate misclassification issues.
  - a. Freedom Communications Inc.
    - i. In November 2008, after five years of litigation and two months of trial, Freedom Communications, which publishes, among others, the Orange County Register, settled for \$42 million with more than 5,000 current and

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<sup>32</sup> *Annual Report of the Joint Enforcement Task Force on Employee Misclassification*, Feb. 1, 2009, available at [http://www.labor.state.ny.us/agencyinfo/PDFs/Misclassification\\_TaskForce\\_AnnualRpt\\_2008.pdf](http://www.labor.state.ny.us/agencyinfo/PDFs/Misclassification_TaskForce_AnnualRpt_2008.pdf) (last visited on March 21, 2010).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

former newspaper carriers.<sup>37</sup>

- ii. The suit alleged that the newspaper carriers were misclassified as independent contractors and, thus, were denied benefits to which they were entitled as employees under California's Labor Code, such as minimum and overtime wages and proper meal and rest breaks.<sup>38</sup>

b. FedEx

- i. In December 2008, after years of litigation, FedEx agreed to pay nearly \$27 million, which included roughly \$12 million in attorneys' fees, to approximately 200 drivers in California who had been misclassified as independent contractors.

c. Microsoft

- i. In 1996, in the case of *Vizcaino v. Microsoft Corp.*, 97 F.3d 1187 (9th Cir. 1996), "freelancers" originally hired by Microsoft as contractors filed a class action lawsuit against the company, seeking employee benefits under the company's retirement and employee stock purchase plan. The court held that the workers met the "common law" definition of "employee" despite the fact that the freelancers were hired with the understanding that they would not be eligible for benefits, were paid through the accounts receivable department instead of through Microsoft's payroll, and were paid higher salaries than comparable common law employees. After the court's ruling, Microsoft settled the case for \$97 million.<sup>39</sup>

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<sup>37</sup> *Gonzalez v. Freedom Commc'ns Inc.*, No. 03CC08756 (Cal. App. Dep't Super. Ct. Orange County), Notice of Class Action Settlement, available at [http://orangecountyregistersettlement.com/pdf/Gonzalez%20v%20Orange%20County%20Register\\_Notify\\_v1.pdf](http://orangecountyregistersettlement.com/pdf/Gonzalez%20v%20Orange%20County%20Register_Notify_v1.pdf) (last visited on March 21, 2010); see also Kathleen Dunham, *Combating the Underground Economy*, LAWDRAGON, available at [http://www.lawdragon.com/index.php/newdragon/fullstory/combating\\_the\\_underground\\_economy/](http://www.lawdragon.com/index.php/newdragon/fullstory/combating_the_underground_economy/) (last visited on March 21, 2010).

<sup>38</sup> *Id.*

<sup>39</sup> Bill Virgin, *Microsoft Settles 'Permatemp' Suits*, SEATTLE PI BUSINESS, Dec. 13, 2000, available at <http://www.seattlepi.com/business/micr13.shtml> (last visited on Jan. 29, 2010).

## B. FUTURE LITIGATION

### 1. Comcast Corp.

- a. The cable services provider has been sued by a former cable installer who alleged that he had been misclassified as an independent contractor.<sup>40</sup> The suit, filed in October 2009 in Massachusetts federal court, also alleged that TriWire Engineering Solutions Inc., the company with whom Comcast contracted to install cable services, had violated the FLSA and state wage laws.<sup>41</sup>

### 2. FedEx

- a. 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, rather than employees.<sup>42</sup> The letter was signed by Attorneys General of Iowa, Kentucky, Missouri, Montana, New Jersey, Ohio, Rhode Island, and Vermont.<sup>43</sup>
- b. 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.”
- c. 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.”<sup>44</sup>

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<sup>40</sup> The action is captioned *Fritz Elienberg v. Comcast Corp. et al.*, Case No. 09-11653, pending in the U.S. District Court for the District of Massachusetts.

<sup>41</sup> Mike Cherney, *Suit Says Comcast Misclassified Workers*, LAW360 (Oct. 2, 2009), available at <http://www.law360.com/articles/125983> (last visited on March 21, 2010).

<sup>42</sup> *Attorneys General Cuomo, Bullock and Milgram Announce Intent to Sue FedEx Ground Over Violations of State Labor Laws - Fed Ex Ground Improperly Classifies Drivers as Independent Contractors, Denying Their Benefits and Crucial Protections Under New York, Montana and New Jersey Law*, Office of the Attorney General Media Center, Oct. 20, 2009, available at [http://www.oag.state.ny.us/media\\_center/2009/oct/oct20a\\_09.html](http://www.oag.state.ny.us/media_center/2009/oct/oct20a_09.html) (last visited on March 21, 2010).

<sup>43</sup> *Id.*

<sup>44</sup> Available at <http://www.ohioattorneygeneral.gov/Briefing-Room/News-Releases/June-2009/AGs-Ask-FedEx-Ground-to-Resolve-Employee-Classific/Letter-to-FedEx> (last visited on March 13, 2010); see also *AGs Ask FedEx Ground to Resolve Employee Classification Issues*, Ohio Attorney General News Releases, June 25, 2009, available

The letter was signed by Attorneys General of Iowa, Kentucky, Missouri, Montana, New Jersey, Ohio, Rhode Island, and Vermont.

- d. Because of the extent of control FedEx was purportedly exercising over its drivers – *i.e.*, drivers’ uniforms are mandated by FedEx, down to the colors of their socks, and the performance of their tasks is directed and supervised by FedEx – the Attorneys General concluded that the drivers were employees under relevant state laws.<sup>45</sup>

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New York, NY  
March 24, 2010

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at <http://www.ohioattorneygeneral.gov/Briefing-Room/News-Releases/June-2009/AGs-Ask-FedEx-Ground-to-Resolve-Employee-Classific> (last visited on March 21, 2010).

<sup>45</sup> *Id.*