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Re: Regulatory Alert: President Obama's U.S. Department of Labor to Challenge Employee and Independent Contractor "Misclassifications"

Dear :

President Obama's federal budget dedicates \$25 million to task the United States Department of Labor (DOL) to combat purported misclassification of "employee" and "independent contractor" status. To that end, DOL will identify and litigate against employers who: (1) categorize workers as independent contractors ("IC's") when, in fact, they are "employees"; or (2) who classify as exempt from overtime those employees who do not meet the requirements of the White Collar Exemptions under Part 541 of DOL's Wage and Hour Regulations.

DOL's New Initiative.

DOL is hiring hundreds of investigators and other enforcement operatives. President Obama's new DOL Solicitor, Patricia Smith, has announced a "Misclassification Initiative" to obtain for misclassified employees the wages, overtime pay, unemployment insurance benefits, social security contributions and health, welfare, and pension benefits and any other entitlements that are available to a company's "employees," but not to IC's. Solicitor Smith has a record of aggressively pursuing "misclassification" actions against employers in her previous role as a state Labor Commissioner.

While DOL traditionally has been hostile toward IC's, it should be noted that other labor and employment-focused government agencies also have aggressively attacked the contractor designation, including the Equal Employment Opportunity Commission (EEOC), the National Labor Relations Board (NLRB), as well as state agencies charged with administering the state's unemployment program, e.e.o. laws, and the like.

Proactive Self-Audits.

It is recommended that employers implement programs that demonstrate the validity of their classification of workers as IC's or as employees who are exempt from overtime. Employers should also develop a plan for addressing DOL audits and enforcement actions before DOL visits your workplace.

To begin, IC's are self-employed individuals who are retained by the employer on a contract basis to perform specified tasks. They usually are compensated on a contract or fee-for-service basis, issued Form 1099's, and are free to contemporaneously render services to other companies.

The use of IC's provides important advantages to employers. However, many employers do not appreciate the substantial legal risks that are associated with utilizing IC's, as well as temporary, leased, and outsourced workers. Employers should not enter into an IC relationship without first undertaking a thorough analysis of the parties' respective legal obligations and status.

From the IC's perspective, that relationship provides an opportunity for the contractor to focus its entire efforts on its area of expertise, and to maintain control over when, where, and for whom services will be performed. It also affords the contractor the opportunity to service different clients and customers in creative ways that are of the IC's choosing.

A key first step in the analytical process is to conduct a proactive self-audit to identify and address areas of vulnerability and to protect your business. Review Form 1099's to identify those individuals who have been paid as IC's. Audit the terms of your IC engagement and employee position descriptions, actual job duties and functions, and the degree of day-to-day control actually exercised by management, among other relevant factors. IC agreements should be carefully reviewed to assure that they do not undermine IC status. Then, determine who, in fact, is an IC and who is an "employee," and, in the latter case, whether the employee is exempt or non-exempt under applicable wage and hour criteria. Employers should pay particular attention to aligning duties and functions performed with the requirements for exemption under the federal Executive (managerial/supervisory), Administrative, and Professional White-Collar Exemptions, and the exemption criteria for computer personnel, among others.

State law also should be reviewed to assure compliance with any state requirements that exceed federal wage/hour guidelines.

Independent Contractor or Employee?

There is no bright-line standard for classifying a worker as an IC or employee. In IRS matters, the IRS inquiry is shaped by the Internal Revenue Code, off-Code provisions, and related defenses. However, the multi-factor common law test that is applied in that and other circumstances is difficult to apply and susceptible to different interpretations, which may well depend on the philosophical bias or bent of the decision-maker. Note further that the test to be applied to determine IC status will vary with the particular labor, employment, or other law that is at issue.

Employers should recognize areas of particular exposure. Certain industries and certain worker classifications are more likely to be scrutinized and targeted for enhanced enforcement than others. Certain fact patterns are more likely than others to be targeted. For example, consider whether your company has hired as IC's part-time personnel, "temporary" workers, technical personnel, former employees or former executives who have retired from or separated from employment with the company, workers who have received ongoing payments from the company during the same year or in prior years, or persons who have received in the same year a

W-2 and 1099 Forms from your company, among other potentially problematic arrangements. Each of these fact patterns (among many others) presents a potential IC classification issue. In defense, the employer must be able to present credible facts and documentation in support of its position. Consideration also should be given to modifying the terms and facts of the employer's relationship with any workers whose status is open to question, in order to enhance your position as to IC status. Likewise, taking immediate remedial measures to recognize "employee" status would be appropriate in circumstances where it appears that misclassification may have taken place, to limit potential liability going forward.

Consequences of Misclassification.

The consequences of worker misclassification, both as to IC's and as to overtime for non-exempt employees, can be severe. Individual, class, and collective actions concerning misclassification are proliferating. The expense to employers can be immense, to include back-pay with interest, liquidated damages, punitive damages, stock options awarded at long-ago lower prices, and legal fees. Misclassification cases are particularly attractive to plaintiff's lawyers. Misclassifying employees may even subject the employer to criminal penalties in some circumstances. Unions also seize on misclassifications as evidence of "mistreatment" of employees, to promote their organizational efforts.

It is noteworthy that IC's, themselves, have attacked IC status designations in order, for example, to qualify for employee stock options, to recover workers' compensation benefits, and to obtain access to employee benefit programs maintained by the company for which they perform services, among other reasons. See, *Vizcaino v. Microsoft*, 173 F.3d 713 (9th Cir. 1999), cert. denied, 2000 U.S. Lexis 479.

"Working Time" Issues.

As part of the audit process, note that plaintiff's lawyers carefully scrutinize virtually every industry in an effort to discover any practices that fail to compensate employees for all of their "working time." For example, working from home, providing no breaks or incomplete breaks due to business demands, permitting employees to eat lunch while on duty, or inadequately compensating employees for travel or training time can result in class actions and large damage and attorney's fee awards. The extensive use of Blackberry's and iPhones further expand the concept of "working time" to situations outside the workplace and the typical work day, thereby increasing the employer's exposure in this area.

DOL's new regulatory activism, President Obama's encouragement of his plaintiff's lawyer and unionist electoral base, and DOL's new activist Solicitor should motivate employers to take the steps necessary to verify that their employees are properly classified and correctly compensated - before they receive notice from the government that their company is being subjected to a wall-to-wall audit.

Feel free to call if you require assistance in any of these proactive endeavors or in your defense activities.