

## The Independent Contractor Question

The use of independent contractors in place of employees has been on the rise in the U.S. for years and continues to stir debate over its impact on worker protections. Congress has recently taken a renewed interest in the subject with the arrival of a Democratic majority, with one representative calling the misclassification of employees as contract workers “a national problem with implications for federal laws and our federal coffers; a problem we must solve.”

**By Irwin Speizer**

When California Overnight, a package delivery service, decided in 2002 to stop using employees as drivers and instead hire independent contractors, some of the drivers sued. Their contention: The switch was a scheme to avoid expensive extras like overtime pay and employee business expenses.

In a ruling that may bode well for companies using independent contractors, a California state court found in February that California Overnight, which is based in San Diego, acted properly. The court said that the company’s delivery drivers were not being misclassified as independent contractors. The decision was a victory for companies trying to reduce costs by using independent contractors in place of full-time employees.

Robert Hulteng, an attorney in the San Francisco office of Littler Mendelson who represented California Overnight, says he has received calls from other trucking and transportation companies about the ruling and expects more widespread interest if the case should survive an appeal.

"I think it could become a very significant case in providing guidance on what you can and can't do in using independent contractors," Hulteng says.

The use of independent contractors in place of employees has been on the rise in the U.S. for years and continues to stir debate over its impact on worker protections. The California Overnight case is among a growing number of court battles around the country filed by independent contractors against companies that hire them.

Congress has recently taken a renewed interest in the subject with the arrival of a Democratic majority. U.S. Rep. Lynn Woolsey, a California Democrat who chairs the House Subcommittee on Workforce Protections, called a hearing in March to begin an examination of the use of independent contractors. At the hearing, Woolsey described the misclassification of employees as contract workers "a national problem with implications for federal laws and our federal coffers; a problem we must solve."

Woolsey pointed out at the hearing that one of the biggest issues surrounding the use of independent contractors is the lack of workers’ compensation insurance and employer-sponsored health insurance. Woolsey says that in California alone, an estimated 30 percent of the state’s 800,000 employers do not carry workers’ compensation insurance. While the hearing focused on workers in the construction industry, a broad range of other

industries use contract workers, including trucking and delivery services, janitorial services, manufacturing and high tech.

Government labor statistics do not specifically track independent contractors but rather lump them in with all contingent workers, a category that includes the staffing industry and temporary help. According to a Government Accountability Office report, there were 42.6 million contingent workers in the U.S. as of 2005—almost a third of the entire workforce.

The staffing industry, a fast-growing group of companies that provides temporary and contingent labor to other companies, is tracking developments in the contract labor field, but so far, it's been from the sidelines. Most staffing companies hire their workers as employees rather than using them as contract labor. By serving as employers of record, those staffing firms make payroll tax deductions, carry workers' compensation insurance and follow other rules required of employers.

"For the vast majority of staffing firms, this is not an issue," says Stephen Dwyer, deputy general counsel of the American Staffing Association. "My take on it is that any company contemplating classifying workers as independent contractors should consult extensively with attorneys and accountants. The ramifications can be drastic to both the company and the workers."

One of the largest ongoing disputes over independent contractors involves FedEx Corp., which set up a separate operating company to handle traditional ground delivery service. FedEx Ground drivers are independent contractors rather than employees of the company.

Like California Overnight, FedEx Ground was sued in a California state court by contract drivers who claimed they operated as employees and should have received benefits as such. In 2004, drivers won the first round in that case after a California state judge ruled that they should, in fact, be treated as employees.

FedEx has been sued by drivers in a number of other states, and the issue is far from settled. In March, lawyers for FedEx Ground contract drivers asked a federal judge in South Bend, Indiana, to combine 32 cases into a nationwide federal class-action suit against the company. If FedEx ultimately loses and its 14,000 drivers are reclassified as employees, the company could be liable for up to \$1 billion in overtime, business expenses, taxes, penalties and other costs, according to estimates.

As with other challenges to independent contractor relationships, the FedEx case revolves around how much control a company can exercise over its contractors before they must be treated as employees. FedEx Ground drivers own and maintain their own trucks and they can hire their own workers or subcontractors to help them service routes.

But the trucks must display the FedEx colors and logos, and the company maintains dress standards and various delivery and operational standards. Drivers who have sued

contend those requirements put them under direct control of FedEx Ground and thus make them employees rather than independent contractors.

Many of the same conditions exist at California Overnight, but there are some important differences. The court decision in the California Overnight case may provide some guidance on how the independent contractor relationship will ultimately be defined.

"The central question is, how much control must a company give up in order to have a contractor relationship?" Hulteng says. "Companies desperately need clarification on where the lines are going to be drawn. The judge [in the California Overnight case] has issued a decision that, if upheld on appeal, will be very helpful in drawing those lines."

California Overnight uses about 1,800 contract drivers to deliver packages around the state. Originally its drivers were employees, although they still had to own their own trucks. In 2002, the company decided to switch to independent contractors to cut costs and increase profits. Some employees kept working for the company as independent contractors, but others left and were replaced by new independent contractors.

When a group of former and current drivers sued, they argued that the switch to contractor status was simply a ruse to avoid paying overtime and other benefits that the drivers had as employees. Drivers were doing the same work—in many cases driving the same trucks. And they were an integral part of the company's core business.

But the company also adopted policies under the new contractor arrangement to put some distance between management and drivers. Delivery drivers did not have to wear company uniforms (although they could earn extra money if they did). They could make pickups and deliveries for other clients if they wanted, and they could turn down assignments from California Overnight. They were free to use other people to make deliveries. How they made the deliveries and handled their routes was up to them. The fees California Overnight paid were negotiated and varied from contractor to contractor. Some contractors prospered under the system and added routes; a few actually bid so low that they lost money delivering packages.

The lawsuit ultimately required decisions from both a jury and a judge. Both reached the same conclusion: California Overnight drivers were not being treated as employees but rather as independent contractors.

Hulteng says that the decisions point to several important items that companies need to consider when deciding to use independent contractors for ongoing tasks:

- The contractor must be allowed to work for other clients.
- The contractor must be allowed the option of turning down assignments.
- The contractor must be allowed the option of having another person do the actual work.
- The contractor must be able to determine how the work will be carried out.

"If I am going to contract out a particular service to an independent contractor, I probably can't say just, 'Joe Smith, do it,' " Hulteng says. "But I can say, 'I want the end product to be a certain way.' You can control the end result. You just can't control how they get there."

While that general principle sounds simple, its application has proved tricky enough to trip up some of the nation's largest corporations. Catherine Ruckelshaus, litigation director for the National Employment Law Center in New York, who testified before the House subcommittee, noted that one of the problems is that there can be differences from state to state.

"You could be found to be an independent contractor in one state and not in another," Ruckelshaus says. "It can get a little bit confusing. Even within the same company they can have different regional practices."

As a result, companies that seek to use independent contractors find they have to hire accounting, tax and legal experts to help set up and run contractor relationships.

For example, Albany, a global contingent workforce consultancy based in London with U.S. headquarters in Fort Lauderdale, Florida, offers a compliance service to help companies meet federal and state rules for using independent contractors. Albany says that on average, 62 percent of workers classified as independent contractors are actually employees.

Albany's Web site features a "[compliance calculator](#)" to give companies an idea of how much they might owe if their independent contractors are determined to be employees. Plug in the number of contractors, the average annual payment to each one, and the estimated number who may not be in compliance and the calculator spits out an estimate of how much the company might owe in taxes, penalties and other assessments.

Jason Posel, Albany's senior vice president in the U.S., says his firm advises companies to take a very cautious approach when using or considering independent contractors. "The trend we are seeing is that IRS is taking a closer look at this, and employees and workers know more about their rights," Posel says. "It is important to take a conservative approach."