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HEADS UP!

INDEPENDENT CONTRACTOR OR EMPLOYEE -- THE $64 MILLION QUESTION?

If employers understood the enormous risks of misclassifying as independent contractors workers who are actually employees under California law, this problem would disappear overnight. The same can be said of misclassifying employees as "trainees" or "volunteers."

Whether or not a worker is properly classified as an employee or contractor is not a matter of contract, but a matter of statute. Accordingly, how the parties choose to characterize or classify the relationship is of very little consequence, if it becomes necessary to have the nature of the relationship determined by a court or administrative agency. This is true even if both parties sign a written contract attesting that it is their intent to create an independent contractor relationship.

The problem typically arises when the working relationship sours, and the putative contractor files a claim for workers' compensation, unemployment benefits, back wages and/or employment discrimination. The alleged employer will often assert the defense that, because the worker was an independent contractor, the laws upon which the claim is based have no application and are thus unenforceable.

At this point, the alleged employer will likely become painfully aware of how difficult it can be to prove independent contractor status.

First of all, California law includes a legal presumption that any person performing services for another is an "employee." Once the evidence establishes that any services were provided, the burden shifts to the alleged employer to prove that the relationship was that of an independent contractor. In making this determination, the court or agency deciding the dispute will focus on the most important consideration: whether the "contractor" retained the power to determine the method and means of how the contemplated work was to be performed. If so, independent contractor status is normally established. If not, the relationship is probably one of employment.

To illustrate, a bone fide painting contractor typically agrees to paint a house for a certain price. The owner specifies the colors he/she wants the house, when the job is to be completed, and the special garden plants that must be protected in the process. Otherwise, the contractor usually retains the power

to determine the brand of paint used, how many employees will work on the project, their working schedules and everything else required to perform the job. This clearly indicates an independent contractor relationship.

In an employment relationship, by contrast, the employer retains the power, whether or not it is exercised, to determine every aspect of how the work will be performed, and is free to change those instructions at any time and to reject any "suggestions" to the contrary.

In one famous class action case, Microsoft discovered the enormous financial exposure that can result from misclassifying employees as independent contractors. In that case, the court ruled that the misclassified employees were entitled to all wages and benefits that they would have been entitled to had they been properly classified as employees.

Accordingly, the court ruled that the plaintiffs were entitled not only to all wages, including overtime, that they would have derived had they been properly classified as employees, but the value of all other benefits of employment as well, including unpaid taxes that should have been withheld by the employer, the value of paid meal and rest breaks (as well as associated daily premiums), paid vacation and sick leave benefits, unemployment insurance, workers compensation insurance and group health insurance.

One last item is worthy of note as well: because Microsoft employees had received stock options during the period in question, the plaintiffs were awarded the value of Microsoft stock options as well.

Based on these rulings, Microsoft settled the case for $199 million. Given the reasonable assumption that Microsoft likely spared no expense on the best legal counsel available anywhere, fair warning is thereby imparted to other sea-farers seeking to traverse the same treacherous route: "What do you bring to the voyage that Microsoft didn't?"

While the numbers may not be as sensational, precisely the same legal analysis applies in all cases involving the misclassification of employees as independent contractors. Employers should be aware that a similar problem exists with the misclassification of employees as "trainees" and "volunteers." Both of these classifications require a very specific legal analysis that supersedes any classification the parties choose to apply to the relationship. This is true even if both agree on the classification, and even if their agreement is memorialized in a signed document. If the required legal analysis results in a finding of employment status, the employer's financial exposure is identical to that discussed above in the Microsoft case.

Due to the widespread problem of misclassification in California, a statute was enacted in 2012 (Labor Code, section 226.8) which imposes substantial additional penalties on employers who knowingly misclassify employees.

It is recommended that employers consider requiring signed contracts for all workers treated as independent contractors. However, apart from simply stating the nature of the relationship, this contract should include a detailed description of the nature of the work contemplated, and with respect to each element of performance, which party retains decision-making authority. It is imperative that this information be accurate, as the Courts are adept at determining "substance over form," and rendering their rulings accordingly.