Independent Contractors: Recent Developments in the Courts

By Aurora Kaiser

The Internal Revenue Service (IRS), the Department of Labor (DOL), and various states have recently been devoting additional resources to remedy alleged worker misclassifications. If the IRS or a state agency brings an enforcement action, it’s a fair bet that private actions claiming wage and hour and other violations will follow close behind.

This Employment Law Commentary looks at recent case developments that could impact how these actions come out.

2012: The Year of Enforcement

Independent contractor misclassification means big tax losses for federal and state governments, and they’re doing something about it. The recent IRS initiative designed to remedy misclassification is expected to reap at least $7 billion in additional federal revenue over the next ten years.

In 2009, the IRS and the DOL announced a massive three-year Misclassification Initiative designed to determine if independent contractors are properly classified. In 2012, the IRS is focusing its sights on big employers after honing its audit, investigation, and prosecution skills on small employers over the past two years.

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we consider the degree to which courts will hold a company responsible for the actions of an independent contractor.

### The Various Tests

Defining an “independent contractor” is among the more difficult and frustrating undertakings for companies. Not only do government agencies have their own multifactor fact-intensive tests, but getting it wrong exposes businesses to government audits, enforcement actions, substantial fines and penalties, individual and class actions, and even criminal prosecution. Businesses need to stay on top of significant developments in the various tests as they could alter the outcome of any given lawsuit or enforcement action.

**Title VII.** In Murray v. Principal Financial Group Inc., 613 F.3d 943 (9th Cir. 2010), the Ninth Circuit clarified for the first time in 2010 what test to use to determine whether an individual is an employee or an independent contractor under Title VII. In so doing, the court looked at the tests variously applied in the lower courts (the economic realities test, the common law agency test, and the hybrid test) and concluded that there was no functional difference among the three. Nonetheless, the Darden common law test is the appropriate test to determine whether an individual is an employee or an independent contractor under Title VII. In so doing, the court reaffirmed the focus of the test is to “evaluate the hiring party’s right to control the manner and means by which the product is accomplished” under the twelve factors set out by the Supreme Court in Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992):

1. the skill required; 2. the source of the instrumentalities and tools; 3. the location of the work; 4. the duration of the relationship between the parties; 5. whether the hiring party has the right to assign additional projects to the hired party; 6. the extent of the hired party’s discretion over when and how long to work; 7. the method of payment; 8. the hired party’s role in hiring and paying assistants; 9. whether the work is part of the regular business of the hiring party; 10. whether the hiring party is in business; 11. the provision of employee benefits; and 12. the tax treatment of the hired party.

**Id.** at 945-46. The Ninth Circuit considered whether Murray, an insurance agent, was an independent contractor and found the following factors to “strongly favor classifying Murray as an independent contractor”: she is free to operate her business as she sees fit, without day-to-day intrusions; she decides when and where to work and maintains her own office where she pays rent; she schedules her own time and is not entitled to vacation; she is paid on commission only; and, in some circumstances, she sells products other than those of the defendant.

**National Labor Relations Act.** In 2009, a case out of the United States District Court of Washington, D.C. caused a stir by appearing to create yet another test to determine independent contractor status: the entrepreneurial opportunity test. The court was analyzing an NLRA claim and stressed that the most important factor is the “entrepreneurial opportunity for gain or loss.” At the time, commentators opined that this case could have significant impact given that the D.C. Circuit’s decisions on labor issues are generally well regarded and it has jurisdiction to review every order issued by the National Labor Relations Board. Nonetheless, the entrepreneurial test does not appear to have gained much traction in the courts, and the decision, *FedEx Home Delivery v. NLRB*, 563 F.3d 492 (D.C. Cir. 2009), has not yet been followed in any published opinion on the importance of entrepreneurial opportunity in conducting the independent contractor analysis.

### Once You Have an Employee, Who is the Employer?

Another test that comes up less often in the context of independent contractors, but...
could have significant impact on potential liability, is how courts define an “employer.” This test only applies after a court or enforcement agency has determined that the service provider should have been classified as an “employee” rather than an independent contractor.

In 2010, the California Supreme Court broadened the definition of “employer” in California by clarifying that the Industrial Welfare Commission (IWC) orders, not the federal standard, define who is an employer in California. The plaintiffs argued that IWC wage order No. 14-2001, entitled “Order Regulating Wages, Hours, and Working Conditions in the Agricultural Occupations,” Cal. Code Regs., tit. 8, § 11140, commonly known as Wage Order No. 14, defined who were their employers for purposes of § 1194. The court held that, in actions under § 1194 to recover unpaid minimum wages, the IWC’s wage orders did generally define the employment relationship, and thus who might be liable. Under the IWC orders, the court concluded, there are three alternative definitions: “(a) to exercise control over the wages, hours or working conditions, or (b) to suffer or permit to work, or (c) to engage, thereby creating a common law employment relationship.”

Choice of Law and Venue

California is well known for its statutory scheme that is highly protective of employees. It is also easier for an individual to show that he or she is an employee in California than in some other states, such as Georgia, Texas, and Florida. For example, in Georgia, a statement in an agreement that the relationship is an independent contractor relationship creates a presumption that such a relationship exists. In Texas, such a statement is controlling. In California, on the other hand, such a statement of the parties’ intent is just one of many factors considered by the courts.

It may be tempting to include choice-of-law and venue provisions in independent contractor agreements to try to avoid the California Labor Code and California independent contractor analysis. This has become, however, increasingly difficult if the independent contractor or employee lives and works in California, though some courts have enforced these provisions.

Enforcing a Choice-of-Law Provision. In a 2008 opinion on summary judgment, the district court in the Southern District of California held that Georgia law governed the dispute because the agreements had choice-of-law clauses and “California courts enforce choice-of-law clauses where, inter alia, the chosen state ‘has a substantial relationship to the parties or the transaction.’”

Employers Cannot Contractually Circumvent the California Labor Code with Choice-of-Law Provisions. In Narayan v. EGL, Inc., 616 F.3d 895 (9th Cir. July 13, 2010), drivers brought a class action alleging, inter alia, they were misclassified as independent contractors. The district court applied Texas law to determine that the drivers were in fact independent contractors, because, under Texas law, declarations in the agreements that the drivers were independent contractors controlled. The Ninth Circuit reversed the district court’s decision and remanded the case for further proceedings. Applying Texas law to evaluate the choice-of-law provision, the Ninth Circuit noted that a choice-of-law clause applies only to the interpretation and enforcement of the
contract itself; it does not encompass all disputes between the parties. Extra-contratual statutory claims, such as those afforded to the drivers under the California Labor Code, would be decided according to state law. The Ninth Circuit reiterated that under California law (unlike Texas law), the parties’ expressed contractual intent regarding classification is only one of several factors used to determine whether a worker has been properly classified.

Employers Cannot Contractually Circumvent the California Labor Code with Venue Provisions. Plaintiff, a California resident, alleged that she and other home-based “Virtual Call-Center Agents” working in the State of California were incorrectly classified as independent contractors, when in fact they were employees under California law. Each call center agent signed a Master Services Agreement with Florida choice-of-law and venue provisions. The defendant moved to dismiss the complaint or, in the alternative, to have the case transferred to Florida. Judge Susan Illston noted that “This is a case of a true conflict of law, and a determination that Florida rather than California law governs plaintiff’s claims could well have the serious practical effect of depriving plaintiff of her unwaivable statutory entitlement to minimum wage and overtime payments.” The court concluded that “Plaintiff has met her heavy burden of proving that enforcement of the forum selection clause in this case would be unreasonable, because it would contravene the strong public policy of California ‘that contractual schemes to avoid the California Labor Code will not be tolerated.’” Perry v. AT&T Mobility, LLC, 2011 WL 4080625 (N.D. Cal. Sept. 12, 2011).

 Liability for Independent Contractor Actions

Even if an employer prevails on a claim that the individuals are independent contractors, the employer may be liable for the independent contractor’s actions. In a recent Second Circuit case, the court concluded that the company was liable for the discriminatory actions of the independent contractor. Plaintiffs have had less luck arguing that the company should be liable for the torts of their independent contractors.

Discrimination. The Second Circuit held that if a company gives an individual authority to interview job applicants and make hiring decisions on the company’s behalf, then the company may be held liable if that individual improperly discriminates against applicants on the basis of age—even if that individual is properly classified as an independent contractor instead of an employee. In this case, the independent contractor told an applicant he was “too old” for the position. Halpert v. Manhattan, 580 F.3d 86 (2d Cir. 2009).

Tort. The California Supreme Court held that when the employee of an independent contractor is injured, the employer of the injured worker is liable for injuries under workers compensation law, not the company (an airline) that hired the independent contractor. The independent contractor’s employee’s arm was injured in the moving parts of a luggage conveyor that the independent contractor was inspecting. Cal-OSHA regulations require the airline to provide safety guards on the conveyor. The trial court granted summary judgment to the airline, but the court of appeal reversed, concluding that the airline had a nondelegable duty under Cal-OSHA to provide safety guards. The Supreme Court reversed: Any tort law duty the airline owed to the independent contractor’s employees only existed because of the work (maintenance and repair of the conveyor) that the independent contractor was performing for the airline, and therefore it did not fall within the nondelegable duties doctrine. “It would be unfair,” the court concluded, “to permit the injured employee to obtain full tort damages from the hirer of the independent contractor—damages that would be unavailable to employees who did not happen to work for a hired contractor. This inequity would be even greater when, as is true here, the independent contractor had sole control over the means of performing the work.” Therefore, the appellate court erred in reversing the trial court’s grant of summary judgment for the airline. Seabright Insurance v. U.S. Airways, 52 Cal. 4th 590 (2010).

Similarly, in Gravelin v. Satterfield, 2011 Cal. App. Lexis 1427 (November 15, 2011), the injured individual was an independent contractor or employed by an independent contractor and was hired to perform work on the landowner’s property. Based on the work status, the action for tort damages was barred absent a triable issue as to whether an exception applied. The court of appeal held that there was no exception. There was no preexisting hazardous condition that was not open and obvious, and there was no violation of the building code that would support an argument that the building code created a nondelegable duty.

Conclusion

States and the federal government are working together to crack down on independent contractor violations, and they have a huge monetary incentive to do so. Companies should periodically take the time to assess whether their independent contractors are properly classified under the current state of the law, and, if not, should make appropriate changes. Even if the company determines that their independent contractors are properly classified, they should be cognizant of how the relationship functions to ensure that they do not inadvertently create a situation in which they could be liable for the independent contractor’s wrongdoing.

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