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5 Tips To Prepare For A Misclassification Crackdown

By **Ben James**

Law360, New York (July 23, 2013, 9:30 PM ET) -- The U.S. Department of Labor under Thomas Perez is expected to come down hard on companies that misclassify employees as independent contractors, but attorneys say businesses that want to avoid the DOL's wrath and stave off lawsuits can protect themselves by following five tips.

Employee misclassification has been on the DOL's radar for years, but Perez's appointment, in addition to the controversial "Right To Know" rulemaking initiative that could force companies to give workers written notice of their classification status, will translate to the agency combating misclassification with renewed vigor, lawyers said.

"There's no question this is a hot area," Morgan Lewis & Bockius LLP partner Michael Puma said. "Every employer that has a meaningful use of independent contractors should be looking at this issue."

Not only does Perez have a background enforcing the law — he previously headed up the Civil Rights Division at the U.S. Department of Justice — but he's gone on the record about the detrimental effects misclassification can have.

In 2008, while secretary of the Maryland Department of Labor, Licensing and Regulation, Perez testified in favor of a state bill targeting misclassification, telling state lawmakers that the practice is "often used intentionally" by companies to lighten their tax burden and dodge workplace protection laws.

"This has been a bee in the bonnet of the ... Labor Department for several years now, so I would anticipate that certainly it will be pursued no less aggressively, and probably more so, under the new labor secretary," said Fisher & Phillips LLP partner John Thompson.

"I think that we can anticipate that there will be enhanced enforcement activity in this area," added Ogletree Deakins Nash Smoak & Stewart PC shareholder Kevin Hishta. "We're certainly seeing a lot of interest on our clients' part to take defensive steps to make sure that contractors are properly classified."

Companies that use independent contractors instead of traditional employees and want to prepare for the expected crackdown would be well served to take a look at both their existing independent contractor agreements, as well as their actual practices, lawyers advised, citing five moves that could prevent potentially costly liability down the road.

Review Written Independent Contractor Agreements

Revisiting a company's written agreements governing relationships with independent contractors is a must for companies looking to take prophylactic steps in light of the DOL's focus on misclassification — and the potential for private wage and hour suits claiming employees weren't correctly categorized, lawyers said.

“A lot of times, you will see independent contractor agreements that are in place that were drafted years ago, that can be enhanced from a contractual standpoint,” Hishta said.

And any businesses that utilize independent contractors but don't have written agreements — they aren't always required — would be well served to put such agreements in place, lawyers said.

Written agreements give the parties a chance to memorialize things like how much control the company has — or doesn't have — over the contractor, and demonstrate both sides' understanding that the contractor is not an employee. An agreement can make clear that the contractor may work for other companies, retain their own employees or subcontractors, and bear its own expenses.

“If there's not a contract, everything's open to interpretation,” Puma said.

Make Sure Agreements Line Up With Reality

A written agreement that articulates the terms of a company's relationship with an independent contactor can be helpful in the event of a classification challenge, but it's usefulness could be nullified if the agreement doesn't reflect the actual, day-to-day realities of the interaction between the company and contractor, noted Thompson.

If the agreement says, for example, that the company doesn't exert control over the contractor — a factor that goes into determining employee vs. contractor status under the Fair Labor Standards Act — but the contractor is actually at the principal's beck and call every workday, the agreement won't provide the company much protection from the DOL or a private lawyer, at least on that point.

“It's not enough to have an agreement, unless what actually happens is consistent with that piece of paper,” Thompson said.

Audit Everyday Practices, Train Employees

Performing an audit of what a company's actual practices are and training employees on how to deal with independent contractors and use the proper terminology when referring to them, are good ways to help ensure that written agreements are actually being implemented, Hishta said.

“There needs to be an understanding that you deal with contractors with more of a hands-off approach than you do with employees,” he said.

In addition to giving employees guidance on how to interact with independent contractors by the book, training can help stop employees from using language that's associated with traditional employment relationships, Hishta said.

Taking the wrong approach to contractors or using the wrong terminology can give an inquisitive regulator or plaintiffs lawyer a “treasure trove” of information, Hishta warned, adding that emails could come back to haunt a company.

“When you have management officials that use email or text messages in their day-to-day routine in addressing issue with contractors, [many] of those emails or text messages are arguably relevant if there is a classification issue,” Hishta said.

Consider Indemnification, Arbitration to Deal With Wage Claims

Companies should consider including indemnification provisions in their independent contractor agreement that provides that the contractor will pick up the tab for the defense costs and any liability if workers of the contractor file suit under a joint employer theory claiming that they have not been properly paid, lawyers said.

And because the law has been developing so favorably for the defense bar when it comes to arbitration and class waivers, an arbitration provision provision barring class or collective actions should be on the table for companies that deal with large groups of independent contractors, Puma said.

“I encourage clients to look at that option,” Puma said.

Keep an Eye On the 'Crazy Quilt' of State Laws

Companies that utilize independent contractors need to worry not only about federal regulators, but what's happening at the state level as well, Pepper Hamilton LLP partner Richard Reibstein said.

Navigating a patchwork of state laws can prove to be extremely challenging for companies that use contractors in more than one state, he noted, adding that such companies need to carefully scrutinize the laws of the states where they do business.

“The toughest issue for multistate companies is how to comply not only with federal law, but with a crazy quilt of state laws on independent contractor compliance,” Reibstein said.

Some states — such as Massachusetts, Connecticut and Illinois — have guidelines for who qualifies as an independent contractor that are very different from those under federal law.

“The point is that this is always evolving,” Puma said. “You need to know the state laws, and how they may be more restrictive than federal law.”

--Editing by John Quinn and Chris Yates.