Legal Backgrounder

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202.588.0302

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COURT SHOULD ESTABLISH CLEAR RULES ON CATEGORIZING "INDEPENDENT CONTRACTORS"

by

Richard A. Samp and Kevin L. Kearns

The U.S. Court of Appeals for the District of Columbia Circuit will hear oral arguments on November 7, 2008 in an important labor relations case. The case will require the court to determine whether a group of transportation workers should be classified as "employees" or "independent contractors." The ultimate answer is reasonably clear: the workers in question really are employees. But the importance of the case lies in how the appeals court reaches that result. In light of the significant consequences facing a company that later is determined to have classified workers incorrectly, companies need clear guidance from the courts regarding how to make those classifications.

The D.C. Circuit case, *FedEx Home Delivery v. National Labor Relations Board* (NLRB) (Nos. 07-1391 & 07-1436), is a petition for review of an NLRB order determining that FedEx Home Delivery improperly classified certain drivers in Massachusetts as independent contractors when they actually were "employees" within the meaning of § 2(3) of the NLRA, 29 U.S.C. § 152(3). As a result, the NLRB held that the workers were entitled to bargain collectively, and that FedEx committed an unfair labor practice when it refused to bargain with the Teamsters Union (which won a representation election among the drivers). FedEx's principal claim in its petition for review of the NLRB's bargaining order is that the drivers are "independent contractors" within the meaning of the NLRA.

The 33 individuals whose status is disputed work Tuesdays through Saturdays delivering packages from two FedEx terminals in Wilmington, Massachusetts to homes throughout the Metropolitan Boston area. The workers maintain some degree of independence: most own their own trucks, and all are permitted to establish the order in which packages are delivered (so long as all deliveries are completed by 8 p.m.) and to arrange for qualified substitute drivers to undertake the deliveries for them. In other respects, FedEx tightly controls how the workers perform their jobs; *e.g.*,

Richard A. Samp is Chief Counsel to Washington Legal Foundation, which filed an *amicus* brief in *FedEx Home Delivery v. NLRB*. **Kevin L. Kearns** is president of the U.S. Business and Industry Council, a non-profit organization that has represented the interests of domestic, American-owned manufacturing, service, and financial businesses, many of them family-owned or closely-held, since 1933.

they must wear FedEx uniforms, display FedEx insignias on their trucks, perform services on a fixed five-day-a-week schedule (with pay levels largely dependent on the number of days worked), accept virtually all packages assigned to them within their normal delivery areas, and refrain from other commercial activity while delivering FedEx packages. The NLRB determined that FedEx's control over the means and manner of the workers' job performance requires FedEx to classify them as "employees."

The Importance of Independent Contractor Status. The independent contractor model – under which a worker maintains a significant degree of independence from those who contract for their services – has had an illustrious history in this Nation's economic development, a history that has been mutually beneficial for both independent contractors and those for whom they perform services. The reasons for the beneficial economic impact of independent contracting is self-evident: those who operate their own businesses and whose incomes are dependent on how successfully they perform have much more incentive than do employees both to work hard and to find innovative ways to perform more efficiently. More than 10.3 million Americans earn their livelihoods as independent contractors.

The Need for Clear Guidance. Appropriate use of the independent contractor model will be hampered, however, unless the courts provide firms with clear guidance regarding when a worker should be classified as an employee and when he/she should be classified as an independent contractor. Firms have strong interests in ensuring that the accepted legal standards for determining worker classifications are employed reasonably, uniformly, and predictably by administrative agencies and others. The "multitude of different tests under a multitude of different statutes" often "condones confusion" within the business community and makes it very difficult for firms to engage in rational business planning. Statement of U.S. Rep. John Kline, Joint Subcommittee Hearing of the House Committee on Education and Labor, at 4 (July 27, 2007).

Setting out clear rules also ensures a level playing field among competitors. When in doubt about the proper classification, many smaller firms will err in favor of an "employee" classification in order to avoid the potentially ruinous financial penalties they could face if a court later determined that someone classified as an independent contractor was really an employee. Yet, doing so will make it difficult for those firms to compete against firms that decide to take advantage of ambiguities in the law and their competitors' caution by inappropriately classifying employees as independent contractors.[1] One recent study concluded that 38% of employers improperly classify at least some of their employees as independent contractors. Tiffany Fonseca, *Collective Bargaining Under the Model of M.B. Sturgis, Inc.: Increasing Legal Protection for the Growing Contingent Workforce*, 5 U. PA. J. LAB. & EMP. L. 167, 174 (2002).

Establishing clearer rules that distinguish between employees and independent contractors would go a long way toward increasing compliance and leveling the playing field among competitors. But

[1]Classifying employees as independent contractors provides a significant competitive advantage to companies that can get away with doing so. For independent contractors, companies do not have to withhold federal, state, local, Social Security, or Medicare taxes; pay the employer's share of employment taxes; pay unemployment or workers' compensation insurance; offer benefits like sick and personal leave, vacation, or health insurance; and pay minimum wage and overtime. Employees looking for a means of evading tax liability also have an incentive to be classified as independent contractors: businesses do not withhold income and payroll taxes from independent contractors.

clearer rules are not possible unless the courts minimize the degree of deference they afford the legal determinations of the NLRB and other administrative agencies in individual cases. Affording deference significantly increases the likelihood that courts will fail to provide similar treatment to similarly situated employers.

The Right-to-Control Test. Unfortunately, courts have applied a wide variety of tests for classifying workers as employees or independent contractors. But many courts, including the D.C. Circuit, have adopted a "right-to-control test" as the overriding factor in making such classifications. "The test requires an evaluation of all the circumstances, but the extent of the actual *supervision* exercised by a putative employer over the 'means and manner' of the workers' performance is the most important element to be considered in determining whether or not one is dealing with independent contractors or employees." *North American Van Lines v. NLRB*, 86 F.2d 596, 599 (D.C. Cir. 1989). If the D.C. Circuit applies the right-to-control test in this case, the conclusion that the FedEx drivers are, in fact, employees is readily self-evident. FedEx closely supervises the "means and manner" by which the drivers perform their tasks. It requires them to work on the five days specified by FedEx, within the relatively tight time frames required by FedEx's customers. It requires them to wear FedEx uniforms, to drive trucks bearing FedEx's insignia, to accept virtually all packages offered to them, and to follow detailed delivery procedures.[2] Drivers have no control over the volume of their business or the prices charged for their deliveries, and all receive roughly the same compensation for the hours they work.

Nor should it matter, under the right-to-control test, that a small number of the FedEx drivers – in Massachusetts and elsewhere – actually receive their paychecks from a fellow driver rather than directly from FedEx. Those drivers are still subject to the same direct supervision by FedEx of the means and manner of their five-day-a-week job performance. Their work status contrasts sharply from the status of truck drivers in cases in which courts have deemed the drivers to be independent contractors. For example, in the *North American Van Lines* case, the drivers of long-haul moving vans were deemed independent contractors primarily because it was up to them to determine how long to wait between accepting loads and how frequently they would drive.

The Entrpreneurial Opportunity Test. Unfortunately, recent D.C. Circuit case law has muddied the waters regarding the proper test to be applied in distinguishing between employees and independent contractors. In one recent case, *Corporate Express Delivery Systems v. NLRB*, 292 F.3d 777 (D.C. Cir. 2003), the D.C. Circuit strayed from the right-to-control test and deferred to an NLRB decision to employ an "entrepreneurial opportunity" test. Under that test, a worker is deemed an independent contractor if his work provides him with "a significant entrepreneurial opportunity for gain or loss." FedEx is urging the D.C. Circuit to employ the entrepreneurial opportunity test to determine that its drivers are, in fact, independent contractors.[3]

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[2]Indeed, it is hardly surprising that FedEx would want to exercise a high level of control, given that the drivers are performing an essential part of the company's normal operations.

[3]In point of fact, the FedEx drivers almost certainly are employees even under the entrepreneurial opportunity test. While the drivers have a theoretical right to hire others to do the driving for them, the failure of any of the 33 single-route drivers in Massachusetts to arrange for such substitution on anything other than an occasional basis suggests that that is not an economically viable alternative. They have no way to build up a business of their own in the absence of the ability to solicit customers, determine rates charged, or to increase compensation more than nominally by delivering more packages. The evidence also indicates that the delivery routes assigned to drivers have no resale value.

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Adoption of the entrepreneurial opportunity test would be a significant setback for those who support adoption of clear judicial guidance regarding when a worker should be classified as an employee and when he/she should be classified as an independent contractor. For one thing, it would place the D.C. Circuit in clear conflict with the majority of jurisdictions that follow the right-to-control test, a test embraced both by the common law and the Restatement (Second) and (Third) of Agency.

More importantly, the entrepreneurial opportunity test is inherently vague, and relying on it to a significant degree will merely lead to increased confusion. Just how easily a worker can avail himself of an entrepreneurial opportunity will rarely be apparent merely by examining the terms and conditions of his contract with the firm for which he provides services. In this case, for example, FedEx urges that the D.C. Circuit examine the records of its drivers throughout the country as evidence that the Massachusetts drivers are offered meaningful opportunities to establish their own businesses. Any test that requires such a sweeping examination does not lend itself to straightforward and predictable application to future cases.

The right-to-control test is not perfect. It will not always be immediately apparent to a business just how much control it can exercise over the work of those who provide services before those workers are transformed into employees. But if the right-to-control test is consistently applied, there is hope that over time a body of case law will establish a reasonably clear line that distinguishes employees from independent contractors. If the D.C. Circuit accepts FedEx's invitation to replace the right-to-control test with the entrepreneurial activity test, all such hope is eliminated.

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