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November 8, 2013

New Case Provides Lessons That May Help Companies Avoid Pitfalls When Structuring Independent Contractor Relationships

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The district court's opinion denying cross-motions for summary judgment in *Bobbitt v. Broadband Interactive, Inc.*, No. 8:11-cv-2855 (M.D. Fla. Oct. 21, 2013) illustrates how not to structure an independent contractor relationship and how not to lay the groundwork to defend that relationship in the event of litigation. The case also serves as a warning that even well-conceived independent contractor relationships may be open to question by a court that is inclined to distrust them.

Background

Broadband Interactive, Inc. (BBI) collected equipment and money when customers discontinued their relationships with a telecommunication company. During the relevant period, BBI used persons known as "CD Techs" to perform that function and treated them as independent contractors. A conditionally certified collective of CD Techs sued BBI for minimum wage and overtime violations under the Fair Labor Standards Act (FLSA) and state law, alleging that they were, under the "economic realities" test, misclassified as independent contractors, and were actually BBI's employees.

Under the version of that test applied in the Eleventh Circuit, courts consider a non-exclusive list of factors to determine whether an individual is the company's employee, including:

> (1) the nature and degree of the alleged employer's control as to the manner in which the work is to be performed; (2) the alleged employee's opportunity for profit or loss depending upon his managerial skill; (3) the alleged employee's investment in equipment or materials required for his task, or his employment of workers; (4) whether the service rendered requires a special skill; (5) the degree of permanency and duration of the working relationship; [and] (6) the extent to which the service rendered is an integral part of the alleged employer's business.

On cross-motions for summary judgment, some of undisputed facts suggested that the CD Techs were truly independent. To perform their work, the CD Techs needed to provide their own vehicles, auto insurance, ladders, tools, safety equipment, and cell phones. CD Techs also determined the order in which they completed the work orders assigned to them, although they had to meet certain timeframes established by BBI.

Other undisputed facts, however, pointed to employee status. BBI derived most of its gross revenues from the tasks performed by CD Techs. No experience or special skills were required to be hired as a CD Tech; a new person could be trained to do the job of a CD Tech in three days or less. CD Techs had limited input into the number or locations of work orders BBI assigned to them. CD Techs who wanted to take a day off from work had to give BBI warning, so that BBI would not assign them routes. BBI required CD Techs to comply with certain specifications and meet uniform and grooming standards. During some time periods, BBI could electronically monitor CD Techs' productivity. BBI forbade CD Techs from having passengers in their vehicles who had not undergone a background check by BBI. CD Techs had no say in the rates BBI paid them. Finally, many of the CD Techs worked for BBI for many years.

Still other factors affecting the analysis were in dispute, including whether BBI punished CD Techs for being late or for other performance issues; whether CD Techs had to attend mandatory meetings; whether CD Techs needed BBI's permission to take a day off from work; whether BBI required CD Techs to work on Saturdays; whether BBI inspected CD Techs' trucks; whether BBI prohibited CD Techs from hiring assistants; and, whether BBI prohibited CD Techs from working for competitors of BBI.

What Should the Company Have Done?

Considering the relative weight of the aforementioned factors, summary judgment—in the plaintiffs' favor—was not beyond the realm of possibility. Although BBI escaped this fate, it also failed to win summary judgment. Barring settlement, the case will proceed to trial as a collective action. Win or lose, BBI stands to pay substantial legal fees and deal with the stress and distraction of preparing for trial. It is worth asking, therefore, what BBI could have done to limit its exposure to a misclassification claim?

First, BBI should have contracted with business entities, not with individuals. Although doing business with a business entity, such as a limited liability company or a corporation, does not guarantee that a court will not consider the employees of that entity to be employees of the contracting entity, it is a powerful consideration in favor of avoiding having the individual service providers treated as employees of the company alleged to be their employer. This is not merely because courts are more likely to conclude that corporations (as opposed to individuals) are economically independent; it is also because individuals who form and manage a business entity are much more likely to satisfy the elements of the "economic realities" test. For example, the opportunity for profit or loss of individuals who form a corporation will depend largely on their managerial skill, given that the success of a business owner typically depends on judgment calls such as hiring and firing decisions, investment in equipment, advertising, training the business' workforce, and negotiating rates with customers. Had the contractors with whom BBI contracted been business entities instead of individuals, it is likely that more of the factors of the "economic realities" test would have favored independent contractor status.

Second, BBI could have contractually allocated the risk of misclassification to those business entities via an indemnification provision. If a subcontracting corporation is aware that *it* will be held liable if its workers assert a misclassification theory against the prime contractor, that subcontractor will have a powerful financial incentive to ensure that, as a matter of economic reality, its employees are not also the employees of the prime contractor. Additionally, should the subcontractors' workers nevertheless sue the prime contractor under a misclassification theory, the prime contractor will have a written agreement to mitigate that risk.

Although such provisions are not common, an indemnification provision between the prime contractor and its subcontractor that allocated the risk that the latter's employees would sue the former under a misclassification provision was upheld in *Itzep v. Target Corp.*, SA-06-CA-568-XR, (W.D. Tex. June 4, 2010). There is no reason to think that BBI could not have availed itself of such a protection here. To ensure that the subcontractors were economically viable enough to make good on their duties of indemnification, BBI might have enlisted the aid of a third-party vendor to screen prospective subcontractors, or insisted that potential subcontractors purchase a bond sufficient to cover their indemnification duties.

Third, BBI should have resisted the temptation to exercise more control over its subcontractors than necessary. For example, although the technology that enabled BBI to monitor its subcontractors' performance may have seemed like a cost-effective way to measure productivity, the benefits of that arrangement came with a high cost: an increase in BBI's exposure to a misclassification claim. The proverbial bottom line is that a company that wants the benefits of doing business with an independent contractor has to be prepared to exercise much less control over that subcontractor than it would exercise over an employee. A company that seeks to have the best of both worlds makes itself more vulnerable to the kind of lawsuit that BBI has to defend.

Fourth, BBI should have audited its independent contractor relationships. Had an auditor taken a hard look at the structure of BBI's relationships with CD Techs before plaintiffs' attorneys performed that role, BBI might well not be in the hot water it is in. For example, such an audit could have revealed weaknesses in the relationships that the company could have addressed before the litigation began.

Finally, BBI should have made a clearer record, from the inception of its relationships with each CD Tech, of the factors favoring independent contractors status. There never should have been disputed facts concerning whether BBI required CD Techs to work on Saturdays, whether BBI prohibited CD Techs from hiring assistants, whether BBI prohibited CD Techs from working for competitors of BBI, etc. The written contracts between BBI and CD Techs should have been clear on these points. BBI should have abided by those contracts, and there should have been occasional, written reminders that CD Techs did not have to work on any particular day, that CD Techs were free to hire and fire their own assistants, and that CD Techs were free to work for BBI's competitors. For example, occasional emails from BBI to its contractors reaffirming these points and asking the contractors to alert BBI if they had any concerns would have made it more difficult for those contractors to dispute such issues. An email record demonstrating that BBI negotiated with its contractors regarding compensation would also have been helpful. Had BBI continually made a record before litigation demonstrating the actual, day-to-day independence of its contractors, it is less likely that there would now be disputed facts on these points, and it is conceivable that BBI might have won summary judgment.

In sum, it appears from the *Bobbitt* opinion that BBI missed significant opportunities to limit its exposure to a misclassification claim. Companies that wish to retain independent contractors would do well to take the prophylactic measures discussed above.

Judicial Discretion

That said, there is no such thing as certainty when it comes to structuring a relationship with an independent contractor. Even a company that does everything right may find itself saddled with a misclassification claim brought by contractors' employees because, when determining a plaintiff's status as an employee or independent contractor, judges have significant discretion. There is a vast universe of potentially important facts vis-à-vis the "economic realities" test, and judges may latch on to certain facts while under-valuing the significance of other facts. This makes it difficult to predict whether a court will consider an individual to be an employee, the employee of an independent contractor, or a simply an independent contractor.

Bobbitt illustrates the point. The court seemed to regard the fact that BBI "punished" its CD Techs for poor performance by refusing to give the CD Tech more work as evidence of an employee-employer relationship. There is little case law to support that proposition, and the *Bobbitt* court's reasoning on this point is hardly intuitive. Indeed, this aspect of the court's analysis creates a Catch-22: if a company terminates or reduces its relationship with a contractor because of the contractor's poor performance, under the Bobbit court's reasoning, that contractor is more likely to be considered the company's employee; if not, the company is stuck with a poorly performing independent contractor. In our view, whether a company limits its relationship with an independent contractor because of the latter's poor performance has no bearing on the "economic realities" analysis. Nevertheless, the *Bobbitt* court, with its wide latitude to implement the "economic realities" test, saw things differently.

Recommendations

Bobbitt provides companies with lessons that they should take into account when structuring and implementing independent contractor relationships:

- Enter into independent contractor relationships with business entities, not individuals.
- Include in the contract an indemnification provision allocating to those business entities the risk for the liabilities that may be imposed in the event their employees sue under a misclassification theory.
- Resist the temptation to try to have the best of both worlds, enjoying the benefits of an independent contractor arrangement while exercising a high degree of control over the worker.
- Periodically audit independent contractor relationships to ensure that the implementation of the contracts reflects the contractors' economic independence.

- During the relationship, to the extent possible, create a contemporaneous record that, in fact, each contractor has *carte blanche* to make decisions that indicate its economic independence.

The *Bobbitt* court's analysis also provides a warning, however, that even well-conceived independent contractor relationships may be called into question, given the flexibility afforded to judges applying the "economic realities" test.

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