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STATE ACTION ADDRESSING CLASSIFICATION AND/OR MISCLASSIFICATION OF TRANSPORTATION WORKERS—AN EMERGING TREND

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Recently, there has been an increasing focus by state governments across the United States on addressing employer misclassification of assorted categories of workers, including transportation workers, due to the significant economic ramifications involved. This focus has resulted in some states taking up legislative action to address the issue. This article provides insight on the impact of misclassification of workers in the transportation industry by reviewing the background of misclassification; discusses recent case law dealing with transportation workers, as well as recent legislative action by one state, Pennsylvania, and forecasts a possible future for both employers and employees.

At its most basic level, misclassification of workers involves the concept of the label of the job not coinciding with the work performed by the actual employee. Common practices can include labeling a worker as an independent contractor; identifying a worker with a lower value job classification for insurance rate setting purposes; and, finally, initially classifying a worker correctly before later increasing the worker's employment tasks without notifying the insurer.

Who has a motive to misclassify? The reality is that employers, both large and small, do have motivation to misclassify. The reasons are varied and complex, but one is a "perceived" cost savings. The perceived cost savings include potentially smaller payments for state workers' compensation premiums; payment of less unemployment taxes; payment of less federal taxes; and not having to pay for costly employee benefits and overtime wages, all of which can reduce a company's operating costs.

Some employers believe that such savings provides them with a competitive advantage. This potential competitive advantage seems all the more important in today's struggling economy, with its constant threat of recession. On the flip side, employers may engage in misclassification simply to remain on a level playing field with competitors who may have been previously engaging in such conduct.

Misclassification is receiving increased attention because, in part, of the significant lost tax revenue involved. The IRS estimates that nearly three billion dollars is lost annually as the result of unpaid Social Security taxes, unemployment insurance taxes, and income taxes, because of misclassification.[3] In addition, state and local governments are

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[3] Employment Arrangements, Improved Outreach Could Help Ensure Proper Worker Classification, U.S. Gov. Accountability Office (GAO), July 2006, at 1-2.

also losing hundreds of millions of dollars. For example, it is estimated that the state of New York, on average, loses over $175 million each year in unemployment tax revenue as the result of employee misclassification.[4] In 2004, Massachusetts estimated losses to include: $12.6 to $35 million to the state's unemployment insurance system; $91 million to the state income tax revenue; and $91 million in unpaid workers' compensation premiums.[5]

Misclassifying can also have significant non-economic implications on the workers themselves. For example, misclassification can deny many workers various protections and benefits to which they would be otherwise entitled to under state and federal law. Worker misclassification can also disrupt labor markets by enabling employers to ignore labor standards afforded to actual employees.[6]

As the result of the serious documented economic and non-economic effects of misclassification, various state governments have gone so far as to create task forces to research and identify misclassification.[7] States are also starting to cooperate with the IRS in identifying entities that knowingly and purposely misclassify workers.[8]

Two recent cases involving transportation workers highlight the possible damages for employers who are accused of misclassification*: Sherman v. American Eagle Express Inc. d/b/a Aexgroup (AEX)*[9] and *Ruiz v. Affinity Logistics Corporation (ALC)*.[10]

In *Sherman*, former delivery drivers allegedly improperly classified as "independent contractors" brought civil suit against AEX, a courier company. AEX contracted with drivers in order to make scheduled deliveries. AEX required that each driver execute a written agreement, which classified them as an independent contractor. Despite the contract language; however, AEX required each driver to adhere to strict business policies and practices. AEX dictated the precise route the driver had to travel on deliveries, and any change of routes had to be pre-approved by AEX. Drivers were required to wear uniforms that had AEX logos; any deviation from this policy could result in fines or payment reduction.

The *Sherman* court, applying Pennsylvania law, noted that, in determining whether a relationship is one of employee-employer or independent contractor, certain factors will be considered which, while not controlling, serve as general guidance. These factors include: the control of the manner that work is to be done; responsibility for result only; terms of agreement between the parties; the nature of the work or occupation; the skill required for performance; whether one employed is engaged in a distinct occupation or business; which party supplies the tools; whether payment is by the time or by the job; whether the work is part of the regular business of the employer; and the right to terminate the employment at any time.[11]

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[4] Linda H. Donahue et al, The Cost of Worker Misclassification In New York State, Cornell Univ. ILR School, (2007), at 2, 10.
[5] Linda H. Donahue et al, The Cost of Worker Misclassification In New York State, Cornell Univ. ILR School, (2007), at 11.
[6] Id. at 2, 6.
[7] Task Force for the Misclassification of New Hampshire Workers**,** http://www.nh.gov/nhworkers**;** North Carolina, EO 125, Establishing the Governor's Task Force on Employee Misclassification, August 2012.
[8] Lauren Rice Burgon, Employee and Independent Contractor Classification-Washington State Partnership with IRS, 2012.
[9] *Sherman v. American Eagle Express Inc. d/b/a Aexgroup, 2012 WL 748400, (D. Pa., E.D.P.A. 2012).*
[10] *Ruiz v. Affinity Logistics Corp., 2012 WL 3672561, (D. Ca. S.D.C.A. 2012).*
[11] *Sherman* at *8-9.

The Court, applying this multi-factor test, concluded that the drivers were "employees" of AEX, rather than independent contractors.

In stark contrast, *Ruiz* went the other direction. There, former furniture delivery drivers brought suit against ALC alleging that they were misclassified and, therefore, would be entitled to various benefits afforded under California law. The drivers who operated on behalf of ALC made home deliveries to customers of large retailers who purchased various types of home furnishings. Drivers were required to execute a contract, which classified each driver as an independent contractor of ALC. ALC leased all delivery trucks before subleasing them to the drivers. Drivers were allowed to accomplish deliveries themselves; however, this was not a requirement. Drivers were allowed to hire other drivers to complete such deliveries. ALC did not directly control the number of hours the driver worked: instead, the length of each day depended on how quickly and efficiently the drivers completed their routes.

The *Ruiz* court noted that under California law, the label which the parties place on their relationship "is not dispositive and will be ignored if their actual conduct establishes a different relationship."[12]

The court noted the primary factor is the "right to control" the manner and means of performance. Secondary factors include: right to terminate at will; distinct business occupation or business; work under principal's direction or by specialist without supervision; skill required; who provides the instrumentalities, tools, place of work; length of time for performance of services; method of payment; work part of principle's regular business; parties' belief; opportunity for profit or loss; and investment in equipment or materials.[13]

The *Ruiz* court ultimately determined that the drivers were not employees of ALC, but were independent contractors. While ALC did exercise some control over the drivers, such control was either unrelated to the manner and means by which the drivers accomplished their work, but was instead related to external regulation or customer preference. The *Ruiz* Court acknowledged, that while some of the factors favored a finding that the drivers were employees, taken together, the factors illustrated that the drivers were indeed independent contractors. It appeared that the court focused on the fact that ALC did not specifically dictate the driver routes and allowed the drivers to hire others to complete their scheduled deliveries. Such lack of control of ALC over the drivers was enough to establish an independent contractor relationship.

Common to both cases was the fact that both employers required the transportation workers to execute a formal written agreement, which classified them as independent contractors, as opposed to actual employees. Despite such contractual language, the end result of each case was very different. The fact is the contractual language between the parties is merely one factor to be considered when making a final determination as to the party's relationship. Courts look far beyond what is stated in a contract and instead engage in a comprehensive analysis of the actual facts of the case. This approach can create inconsistent decisions:, one fact pattern can be decided in favor of the employer in one courtroom, and that same fact pattern can be decided in favor of the worker in another.

[12] *Ruiz* at *3.
[13] *Ruiz* at *4-14.

An emerging trend, however, shifts the handling of the issue from the courtroom to the state assembly. The reasoning is both economic and practical. Legislation can create a bright line rule, by identifying distinct guidelines that must be met in order for a worker to be classified as an independent contractor. This, in turn, can reduce perceived employer abuse of classification, through definitive penalties for determined violations. The practical effect helps to level the playing field between all employers, making them play by the same rules in classifying workers. Further, the legislation is perceived to help to protect workers and to contribute to the economic growth and prosperity of society by preventing improper tax avoidance by employers.

A good example of a recent legislative action enacted to prevent perceived worker misclassification is Pennsylvania's Construction Workplace Misclassification Act (CWMA).[14] This law, enacted in February 2011, was prompted by backlash against the construction industry. The CWMA provides narrow guidelines which must be met before an individual who performs construction work can be considered an independent contractor. The immediate effect of the CWMA requires that workers who were previously classified as independent contractors must be reclassified as employees in order to comply with the CWMA. CWMA provides significant monetary and non-monetary consequences for misclassifying an individual as an independent contractor. The economic implication of violations are significant as each misclassified worker is considered a separate offense. In addition, violations of the CWMA can lead to a cease-work order, requiring the cessation of work by misclassified individuals within 24 hours, individual liability, as well as criminal sanctions.

Since CWMA went into effect in 2011, it has been effective. In the first year, the Pennsylvania Bureau of Labor Law Compliance received and investigated 29 complaints involving 106 different types of allegation.[15]

In July 2012, the Pennsylvania legislature attempted a further "crackdown" on employee misclassification by introducing House Bill No. 2540, which, for the first time in Pennsylvania, specifically targets the "transportation" industry. To date, the bill has not been voted on, but was referred to the Committee on Labor and Industry however.

House Bill No. 2540, entitled "The Commercial Carrier Industry Workplace Misclassification Act" (CCMA), provides restrictive guidelines, which must be met before a worker operating in the transportation industry can be considered an independent contractor. The proposed bill broadly affects any employer in Pennsylvania who deals with passengers or property "through, over, above, or under land, water or air." The heart of the proposed bill states that an individual is an independent contractor only if 1) the person has a written contract to perform such service; 2) the person is free from control or direction both under the contract and in fact; and 3) the person providing the service is customarily engaged in an independently established trade, occupation, profession or business. Factors like the failure to withhold Federal or State income taxes or pay unemployment compensation premiums are expressly not to be considered.

[14] 43 P.S.§§933.1 – 933.17.
[15] Administration and Enforcement of the Construction Workplace Misclassification Act in 2011. Julia K. Hearthway, Secretary of Labor & Industry Commonwealth of Pennsylvania.

Like the CWMA, the CCMA provides for significant civil penalties, as well as criminal penalties for intentional violations of the act. The similarities between the two laws illustrate the legislature's confidence in the application and benefits derived of legislation as opposed to leaving the issue of worker misclassification up to the judiciary.

In conclusion, transportation employers operating business in Pennsylvania need to strongly consider their current employee relations policies, and, if necessary, begin to make appropriate changes in order to ensure future compliance with applicable worker classification legislation. Making sure all independent contractors be incorporated and provide up-to-date certificates of insurance would help immensely in the short term. Further, if not previously utilized, employers should document all employment relationships via written agreement, which specifically defines the terms of the relationship. Likewise, employers should have written job descriptions for each position offered. Employers should further institute a review policy that periodically ensures the written job descriptions coincide with the actual duties performed by the worker engaged in each position. Such progressive actions will help attain compliance with worker classification legislation. Such compliance will not only benefit the employer, by avoidance of harsh civil and criminal penalties, but also provide applicable protection to workers afforded by proper classification.