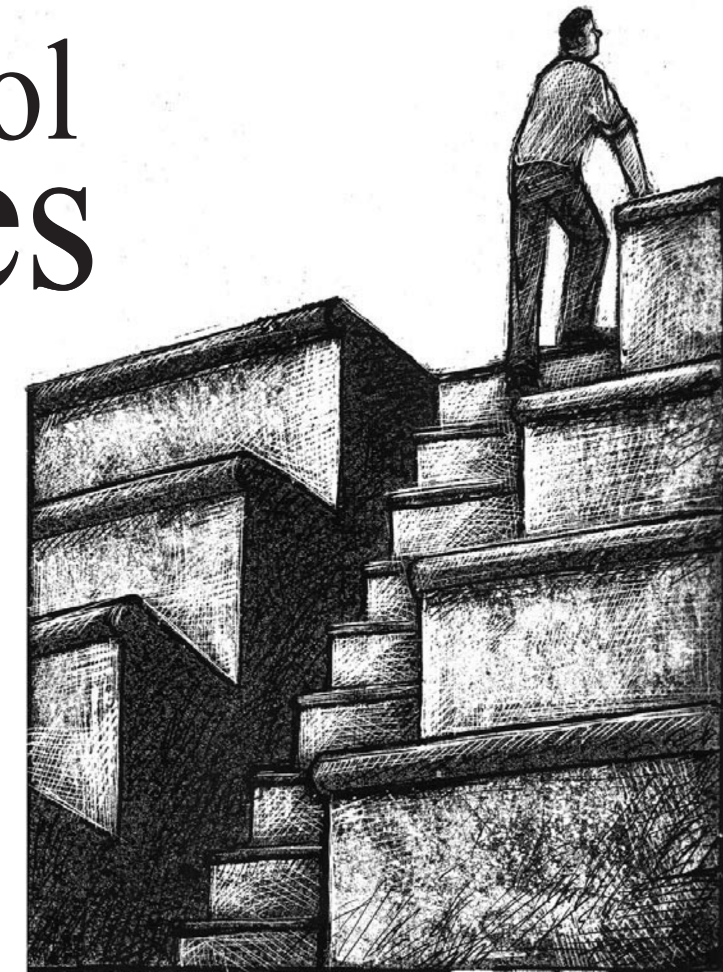
Labor

Control Issues



By Karen L. Gabler

Given California's stringent employee-friendly labor laws, business owners often try to avoid their reach by labeling their workers "independent contractors." Unfortunately, owners often don't realize that misclassifying an employee as an independent contractor can result in multiple liabilities for damages and penalties far outweighing the cost of properly maintaining employees on the payroll.

In 2006, California courts continued their highly conservative application of the factors relevant to the independent-contractor analysis. In *JKH Enterprises v. Department of Industrial Relations*, 142 Cal.App.4th 1046 (2006), the Court of Appeal reviewed and upheld a stop order and penalty issued by the California Department of Industrial Relations against JKH Enterprises for failing to carry workers' compensation insurance for its drivers.

JKH Enterprises, dba AAA Courier, provides courier services to San Francisco Bay Area businesses. Its drivers were engaged by JKH to pick up packages from JKH customers and deliver them to their intended destination. JKH employed "route" drivers, paid by the hour and responsible for traveling a particular customer route, and "special" drivers, who contacted a dispatcher each day to inform him whether they wished to work that day. The special drivers did not have to accept any particular assignment and were paid by commission.

JKH did not monitor the drivers' whereabouts or the anticipated timing of their deliveries from day to day and did not supervise the drivers or require them to stay in contact with a dispatcher while they were out on assignment. The drivers filled out a form document titled Independent Contractor Profile, on which they acknowledged their independent-contractor status and provided their automobile insurance information. Beyond this document, however, no written agreement between JKH and its drivers covered the terms of any independent-contractor relationship.

All JKH drivers used their own vehicles and paid for their own gas, car service and maintenance and insurance. They used their own cell phones. Their cars bore no JKH markings, and the drivers didn't wear uniforms. Some of the drivers performed delivery services for other companies, and two of them had their own business licenses and provided the delivery services on behalf of their own businesses. The drivers received no particular training, other than brief instruction on how to fill out the log sheets to verify customer deliveries and show the locations of pick-ups and deliveries.

The drivers set their own schedules, chose their own routes and took time off when they wanted to, without asking permission to do so. They were paid twice a month with no deductions and were issued a Form 1099 at the end of the year. The route drivers were paid a portion of the fees charged to customers at a negotiated hourly rate, and the special drivers were given a cut of the fee charged to the customer for a particular delivery.

An inspector for the Department of Industrial Relations noted that JKH did not procure workers' compensation insurance for its drivers, having classified them as independent contractors. The inspector determined that the workers were "employees" and issued a stop order and notice of penalties, requiring JKH to shut down operations until it obtained workers' compensation for its drivers. At the department hearing requested by JKH, the hearing officer applied the "multifactor," or "economic realities," test to the independent-contractor analysis, noting that, although some of the evidence in the case might point to independent-contractor status, the drivers were employees because their work was an "integral part" of JKH's business. "Even though there is an absence of control over the details," the court writes, "an employee-employer relationship will be found if the [principal] retains pervasive control over the operation as a whole, the worker's duties are an integral part of the operation, and the nature of the work makes detailed control unnecessary." *JKH.*

JKH appealed the decision to the trial court and the Court of Appeal. Both courts upheld the stop order and penalty award, citing *S.G. Borello & Sons Inc. v. Department of Industrial Relations*, 48 Cal.3d 341 (1989), as the "seminal case" regarding the analysis of a worker's status as an independent contractor or employee.

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The Court of Appeal noted those factors typically relevant to whether a worker can be considered an independent contractor. These factors include 1) whether the business can fire the worker at will, 2) whether the worker is engaged in a distinct occupation or business, 3) whether the work is usually done under the direction of the principal or by a specialist without supervision, 4) the skill required in the particular occupation, 5) whether the principal or the worker supplies the instrumentalities, tools and the place of work for the person doing the work, 6) the length of time for which the services are to be performed, 7) the method of payment, whether by the time or by the job, 8) whether the work is a part of the regular business of the principal, 9) whether the parties believe they are creating an employer-employee relationship, 10) whether the classification of independent contractor is bona fide, not a subterfuge to avoid employee status, 11) the worker's degree of investment in the business and whether he holds himself or herself out to be in business with an independent-business license, 12) whether the worker has employees, 13) the worker's opportunity for profit or loss depending on his or her managerial skill, and 14) whether the service rendered is an integral part of the alleged employer's business.

JKH, like numerous California business owners, relied heavily on the lack of control it exercised over its drivers in arguing that they should be considered independent contractors. In *Borello* and in *JKH*, however, the court noted that a minimal degree of control exercised by the employer over the details of the work is not dispositive when the work does not require a high degree of skill and is an integral part of the employer's business. In that case, the employer is considered to be exercising all necessary control over the operation as a whole.

Thus, in *JKH*, the court noted that the functions performed by the drivers, including pick-up and delivery of papers or packages and driving between locations, did not require a high degree of skill. At the same time, however, those functions "constituted the integral heart of JKH's courier service business." By obtaining the clients in need of the service and providing the workers to conduct it, the court found that JKH retained all necessary control over the operation as a whole, rendering the drivers employees rather than independent contractors.

The court found disturbing the fact that Joe Herrera, the owner of the business, previously operated a courier service business known as VIP Courier. That business also received a stop order based on the same misclassification of drivers as independent contractors. In response, Herrera closed his business and reopened as JKH Enterprises, doing the same work under the same conditions as those performed as VIP Courier. Not unexpectedly, the court called Herrera's acts a "subterfuge" designed to avoid the impact of the workers' compensation laws.

Also significant to the decision was the fact that JKH paid its route drivers by the hour. In the case of *Millsap v. Federal Express Corp.*, 227 Cal.App.3d 425 (1991), cited by JKH, the drivers were paid after submitting invoices for a particular job, thus entering into a new "contract" each time a delivery was made. The court also distinguished the case of *State Compensation Ins. Fund v. Brown*, 32 Cal.App.4th 188 (1995), cited by JKH, by noting that the drivers in Brown drove trucks requiring increased skill and expertise and that the drivers had invested significant capital in their own trucks. It is debatable whether the distinction between the trucks driven in *Brown* and the vehicles driven by JKH drivers should be sufficient to establish an independent-contractor relationship as opposed to an employer-employee relationship.

Most important to the court, however, was the fact that neither of the cases cited by JKH addressed the issue of procuring workers' compensation insurance for drivers. "In the workers' compensation context, in addition to the 'control' test, the question of employment status must be decided with deference to the purposes of the protective legislation. The nature of the work, and the overall arrangement between the parties, must be examined to determine whether they come within the 'history and fundamental purposes' of the statute." *Borello.* Those purposes include ensuring that the cost of industrial injuries will be borne by the business, guaranteeing prompt compensation for employee injuries, spurring increased industrial safety and insulating employers from tort liability for employee injuries. As the *JKH* court noted, the workers' compensation scheme attains comprehensive coverage of injuries in employment by defining "employment" broadly in terms of "service to an employer" and by including a general presumption that any person "in service to another" is a covered "employee." *JKH.*

Although the court's analysis highlights certain inconsistencies in California's competing decisions on the status of workers as independent contractors, business owners should remain cautious when classifying a worker as an independent contractor rather than an employee.

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Joseph W. Cotchett is senior partner at Cotchett, Pitre & McCarthy. As stated by the National Law Journal, he is considered by plaintiffs and defense attorneys alike to be one of the foremost trial lawyers in the country. During his 40-year career, he has tried more than 100 cases in the areas of antitrust, securities, intellectual property, First Amendment and major fraud. He received his Bachelor of Science in Engineering from California Polytechnic College, San Luis Obispo (1960), being named an Outstanding Graduate, and his Juris Doctrine from the University of California Hastings College of Law (1964). Cotchett is a Fellow of the American College of Trial Lawyers, the International Society of Barristers, the International Academy of Trial Lawyers and an Advocate in the American Board of Trial Advocates. He is the author of numerous treatises on trial and evidence.

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APRIL 19, 2007 EVENTS

12 p.m. - 1 p.m.
"Career Retrospective"
Bannan Hall, Room 127

5 p.m. - 6 p.m.
Reception
Strong Room, Bergin Hall

6 p.m. - 7 p.m.
"The Ethics Gap in Our Profession"
Edward Panelli
Moot Court Room,
Bergin Hall

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by April 13, 2007