

# Employment Law Newsletter

*by David A. Tonini**edited by L. Anthony George*

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## EMPLOYEE MISCLASSIFICATION TOPS ENFORCEMENT LIST IN 2010

In 2010, employers can expect an unprecedented increase in enforcement efforts targeting employees misclassified as Form 1099 independent contractors. Attention to this issue has been growing in recent years. However, with state and federal budget deficits now headlining the news, and cash-strapped governments aggressively searching for unrealized tax revenue, the time is right for this nagging issue to become a major headache for employers. The IRS recently announced that in February 2010, it would begin a national audit targeting up to 6,000 employers, with the goal of quantifying the revenue shortfalls created by misclassification of employees. Two-hundred auditors have already begun training to staff this new program. Furthermore, the Department of Labor's Wage and Hour Division and twenty-nine states have signed up to collaborate with the IRS and share the results of their own misclassification-related audits.

In addition to increased tax revenue, state and federal agencies are also seeking significant penalties from employers who have misclassified their workers. On December 10, 2009, the Illinois Department of Labor (IDOL) announced that it had imposed a \$328,500 civil penalty against a first-time offender. IDOL assessed penalties of \$1,500 per day for 218 days of alleged misclassification and an additional fine of \$1,500 for the company's failure to maintain proper records on the misclassified employees. New York also reported recently that it had uncovered 12,300 instances of misclassification in 2009. The fines and penalties imposed on those employers totaled nearly \$6 million. With even more enforcement efforts slated for 2010, more such penalties are likely to follow.

### Could You Have a Problem?

The starting point for analysis of a worker's classification is the IRS test. The familiar "20-factor test" has been reformulated into an analysis of three characteristics of the relationship between a business and its workers:

- behavioral control
- financial control
- type of relationship

"Behavioral control" relates to the degree of employer control over how the worker performs the work. Factors suggesting employee status include: (1) significant employer instructions regarding how, when, and where to perform the work; (2) evaluation systems that measure how the work was performed rather than merely the end result; and (3) training in how to perform the work, including specific procedures and methods to follow. The "financial control" factors relate to the amount of employer control over the economic aspects of the worker's job. Indicators of a lack of financial control, and thus independent contractor status, are the worker's: (1) significant investment in tools and equipment; (2) unreimbursed expenses; (3) opportunity for profit or loss; (4) freedom to provide services to multiple employers; and (5) payment by flat fee or at a job rate rather than by salary or an hourly rate.

Finally, the IRS looks at how the worker and employer perceive their relationship. What does the contract say? Does the employer provide benefits? Is there permanency or a set duration of the relationship? Is the worker involved in key activities of the business? If the employer provides benefits and a long-term role in a core aspect of the business, the worker is more likely to be an employee. In contrast, independent contractor status is more likely where a written contract specifies such status, provides for no employment benefits, and calls for short-term services unrelated to the core aspects of the business.

### Added Complexity From Conflicting Laws

Employers must bear in mind that the definition of "independent contractor" varies from statute to statute, agency to agency, and state to state. For example, federal courts and the U.S. Department of Labor use a more liberal "economic realities" test to determine worker status for



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purposes of federal employment laws such as the Fair Labor Standards Act, Title VII of the Civil Rights Act of 1964, the ADA, the FMLA, and the WARN Act. In addition, state unemployment and workers' compensation statutes often use entirely different criteria for determining employee status, such as the nine-factor test set forth in the Colorado Employment Security Act.

This maze of conflicting requirements creates a minefield for employers. For example, a worker who satisfies all of the IRS's three-part test for independent contractors may nevertheless be an employee under the Colorado unemployment statute if the paychecks are issued in the worker's individual name, rather than the name of a business entity.

### Where Do We Go From Here?

As seen in the recent IDOL case, the cost of misclassification can be severe. Improperly categorizing employees as independent contractors exposes employers to liability for federal and state taxes, wage and hour violations, unanticipated coverage by employment laws, and claims under state wage payment statutes. In addition, many states are also increasing their statutory penalties for misclassification. For example, Colorado raised its penalties in June 2009 to fines of \$5,000 per misclassified employee for a first offense and up to \$25,000 per misclassified employee for a second or subsequent offenses. Fortunately, employers can take specific steps to mitigate the risk and safely navigate the murky waters the many conflicting standards create. These include:

- consultation with employment counsel regarding the applicable standards;
- thorough review of all workers currently classified as independent contractors;
- reclassification of those who are clearly employees; and
- restructuring the remaining relationships to satisfy as many of the independent contractor factors as possible, including execution of an independent contractor agreement that closely tracks the various requirements of federal and state law.

## DISCRIMINATION COMPLAINTS NEAR HISTORIC HIGH IN 2009

In a year-end review, the Equal Employment Opportunity Commission reported that workplace discrimination complaints in 2009 reached the second-highest level in history. In total, 93,277 claims were filed with the Commission in 2009, resulting in a record-high \$294 million in payments or penalties through administrative enforcement and mediation.

The most frequently filed charges in 2009 were complaints alleging race-based discrimination (36 percent), retaliation (36 percent), and sex discrimination (30 percent). However, the data shows that three other types of discrimination complaints are on the rise. Disability complaints increased by 10 percent over 2008 levels, while national origin complaints rose 5 percent and religious discrimination claims were up 3 percent. Age-based claims dipped slightly from their record-high numbers in 2008.

Discharge claims continue to be the most costly. In this economic climate, every claim of discriminatory or retaliatory discharge carries greater economic risk, as the complainant will likely find it much harder to obtain new employment with comparable compensation. Therefore, even more than in good economic times, employers in a recession should carefully review all terminations for the "red flags" that might support a claim of discrimination or retaliation. These may include, among many others:

- lack of adequate documentation;
- inconsistency with past treatment of similar situations;
- inappropriate comments made by the decision-maker or in connection with the termination;
- recent protected activity by the employee (such as making a harassment complaint);
- for performance-based terminations, failure to provide adequate notice of the performance deficiencies and a reasonable opportunity to correct them;
- for economic-based terminations, inability to explain clearly why this worker was selected for termination over others not in the same protected class (e.g., why the African-American was laid off while white workers in similar positions were retained).

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## OSHA ON YOUTUBE

The Labor Department's Occupational Safety and Health Administration (OSHA) has begun posting training and safety videos on YouTube. The first videos, which are offered both in English and in Spanish, concern respirator safety and protecting workers from exposure to chemical and biological hazards in the workplace. These videos were uploaded first in order to address lingering fears of a pandemic influenza outbreak this year. More videos are expected to be uploaded soon, and they can be found by searching the YouTube website for the user USDepartmentofLabor. As this portfolio of videos is developed, it should provide an effective, easy, and free resource for employers seeking to implement or expand an OSHA training program.

### Labor Look *by L. Anthony George*

#### UNION-FREE EMPLOYERS NEED UNION AVOIDANCE STRATEGIES, POLICIES NOW

American labor unions suffered a net loss of 771,000 members in 2009, the U.S. Bureau of Labor Statistics reported in January 2010, a decline the agency attributed largely to the recession. Such a massive loss of dues-paying members may prompt more aggressive union organizing efforts in 2010 and 2011, and union-free employers should prepare now for the assault. In addition, while the U.S. Senate defeated union activist Craig Becker for a seat on the National Labor Relations Board in February 2010, the Obama Board is nevertheless expected to make life much easier for union organizers over the next few years. As part of a comprehensive union-avoidance strategy, union-free employers should consider the following:

- Non-solicitation and non-distribution policies can be a significant impediment to union organizing efforts within the workplace, but such policies must comply with the National Labor Relations Act (NLRA). Under the NLRA, employers may ban employees from soliciting in the workplace, but only when either the soliciting or the solicited employee is on "working time" (i.e., when he/she is actually supposed to be working and not on a break). Employers may ban employees from distributing literature on the employer's property, but only in working areas of the property or when the employee is on "working time." Such bans must apply neutrally to all solicitations and distribution and not merely to union-related activity.
- Employers may ban third parties from soliciting or distributing literature anywhere on the employer's property but must be mindful of certain restrictions pertaining to shopping malls and remote worksites. In addition, such bans must generally apply to all third-party solicitations and not merely to union-related activity.
- Employers may require off-duty personnel to leave the premises, thereby reducing their opportunity to engage in union organizing activity on the employers' property. However, such a policy must be distributed in writing to all employees and must allow off-duty personnel to remain in non-working areas of the property, such as break rooms and parking lots.
- Once a petition for a union "recognition" election has been filed (and often for some period of time before the petition is filed), employers may no longer "solicit grievances" by asking employees to identify the issues that are troubling or upsetting them. One exception to this rule exists where the employer had a well-established practice of "soliciting grievances" before the union organizing activity began. Therefore, employers should consider establishing a practice of regularly soliciting employee feedback now, before union organizers arrive on the doorstep.
- Employers should review their compensation and benefit policies to ensure that they fit the employer's overall union avoidance strategy and do not needlessly create dissatisfaction that union organizers might exploit.
- Finally, employers should remember that "soft" concerns over poor supervision and poor communication are often more likely to drive employees into the arms of a union than are "hard" issues like pay and benefits. Therefore, any union avoidance strategy should begin and end with a careful look at how the supervisors manage and treat their employees from day to day and how well upper management maintains good two-way communication with rank-and-file workers.

Being union-free is never guaranteed. It takes continual effort and thoughtful planning—now more than ever.



### HRO's Going Green

In an effort to help save the Earth's natural resources, HRO would like to extend to you the opportunity to receive the Employment Law Newsletter electronically. HRO keeps archival copies of the newsletter on our website under the Publications section: <http://www.hro.com/publications>.

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## California Corner *by Nicole D. Gomes*

### TWO RECENT WINS, ONE SETBACK, FOR CALIFORNIA EMPLOYERS

In California, as elsewhere, the courts giveth, and the courts taketh away. Two recent wins for employers in the Golden State were accompanied by a setback for individual supervisors and managers.

#### Win One: Court's Discretion to Deny Award of Attorney Fees

We may expect to see fewer big attorney fee awards on small judgments in California employment cases. On January 14, 2010, the California Supreme Court held in *Chavez v. City of Los Angeles*, 47 Cal.4th 970 (2010), that a state civil procedure rule authorizing denial of attorney fees and costs in certain cases applies to employment discrimination claims brought under California's Fair Employment and Housing Act (FEHA). That rule, Section 1033 of the California Code of Civil Procedure, allows judges to deny fees and costs to a prevailing party who recovers a judgment that could have been rendered in a limited civil case (i.e., less than \$25,000) but who failed to bring the action as a limited civil case. Thus, prevailing plaintiffs under FEHA are now less likely to recover big-dollar attorney fees in small-dollar cases.

#### Win Two: Limit on Punitive Damages

On November 20, 2009, the California Supreme Court, in *Roby v. McKesson*, 47 Cal.4th 686 (2009), brought itself in line with federal courts by limiting punitive damages to the amount awarded as compensatory damages in that case. That is, the Court held that the jury's award of punitive damages against an employer exceeded the 1:1 ratio between compensatory and punitive damages allowed by the United States Constitution. The Court established three factors to consider when awarding punitive damages: 1) the degree of reprehensibility; 2) the disparity between the harm suffered by the plaintiff and the size of the award; and 3) the difference between the punitive damages awarded by the jury and civil penalties imposed or authorized in comparable cases. Based on the facts of the *McKesson* case, the Court held that the amount of compensatory damages set the ceiling for the punitive damages.

#### Setback: Individual Liability for Discrimination?

In the *McKesson* case, the Court blurred the distinction between discrimination and harassment with respect to individual liability. Under California law, individuals cannot be liable for discrimination, but they can be liable for harassment. One basis for this distinction is that discrimination involves official employer actions (e.g., hiring, firing), while harassment arises from what individuals say or do to make the environment hostile. In *McKesson*, the Court held that the same conduct could be both discrimination and harassment because the official employment action could communicate a hostile message. By blurring the distinction between discrimination and harassment, this case may make it easier for employees to impose liability on individuals for what is essentially harassing conduct.

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