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Employers Who Utilize Independent Contractors Should Take Steps to Avoid Employee Misclassification Claims

By Bruce Garrett

The common employment law issue that employers who use contractors face at one time or another is whether a certain worker is an employee or an independent contractor. For instance, state and federal minimum wage and overtime regulations, family medical leave laws (or paid family medical and sick leave in states that offer it, such as Oregon), and workers' compensation coverage, only apply to employees—not independent contractors. Similarly, many equal opportunity, health and safety, and workplace liability laws only govern the employer-employee relationship. And of course, employers are not required to incur payroll taxes or offer employment benefits to independent contractors.

Against this backdrop, it's easy to see why many businesses are eager to utilize independent contractors. This desire will likely continue to grow as technology and automation create narrow and discrete demand for services and as an unprecedented labor shortage leaves employers scrambling to find workers in order to keep their operations running.

However, employers often mistakenly misclassify employees as independent contractors, and the cost for doing so can be quite high. For example, misclassification may lead to claims of failure to pay wages, including applicable minimum wage or overtime, which are costly to defend, may carry heavy monetary damages and stiff penalties, and require the employer to pay the worker's attorney fees.

What Test Applies?

Part of what drives the confusion about employee classification is that employers cannot rely on a single definition of "employee" when classifying a worker as an independent contractor. For example, Oregon's Employment Department uses a different test to determine whether a worker is an employee or independent contractor than the Internal Revenue Service utilizes. Similarly, a worker may be considered an independent contractor under the federal Civil Rights Act (and thus not covered), but may be considered an employee under a state's anti-discrimination statute.

There are two tests that courts generally use to determine employee classification: the right to control test and the economic realities test.

The right to control test gauges the degree of control that the employer uses to control the manner and means of the worker's job; the more control exerted by the employer, the more likely the worker will be classified as an employee. No one factor controls, but courts generally look at whether the worker sets their own schedule, the degree of independence and judgment afforded to the worker to complete the job, who furnishes the tools or equipment, and the method of payment (e.g., hourly or by-the-job basis).

The economic realities test is broader and it sweeps more workers into the employee classification camp. Although it utilizes many of the same factors as the right to control test, the economic realities test generally turns on whether a worker is in business for themself or whether they are economically dependent on the employer.

Legislative Changes

With the emergence of the "gig economy"—propelled by services such as ride share and food and grocery delivery—many state legislatures are either adopting or considering legislation that would transform many independent contractors into employees. In the most recent legislative session, a bill was introduced in Oregon that would adopt a standard similar to the economic realities test for wage and hour rules, but the bill never made it out of committee. Similarly, the U.S. Department of Labor (DOL) published a rule early this year adopting the economic realities test under the Fair Labor Standards Act, but the DOL withdrew the rule after considerable public comment and pushback. Despite these stalled efforts, the writing is on the wall: employee classification is on the minds of policymakers and the law could change in the near future.

Best Practices

Employers often rely too heavily on the method of payment as a means for classifying their workers. An employer may pay a worker 1099 instead of W2 wages, but this factor does not determine, by itself, whether the worker is an employee. Similarly, giving a worker the title of independent contractor (even if used consistently on official records or forms) is not determinative.

A well-drafted independent contractor agreement—especially one that carefully describes the relationship between the worker and the employee and the duties and responsibilities of both parties—can help limit employee misclassification, but it will not be the decisive factor if the worker files a lawsuit.

As a general rule of thumb, employers should do a side-by-side comparison of their independent contractors and employees. If the two are indistinguishable in terms of duties, responsibilities, or other key characteristics, there is likely a misclassification issue. But short of these obvious cases, employee classification is a very fact-specific, case-by-case inquiry. Employers who utilize independent contractors, whether exclusively or as a mix with employees, should seek counsel from an employment law attorney to help limit their exposure to the very costly and litigious threat of employee misclassification.

For questions related to employee classification or any other employment matters, contact Barran Liebman attorney Bruce Garrett at 503-276-2175 or bgarrett@barran.com.