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In the News Again: Worker Misclassification Enhanced Enforcement Efforts and Broader Damages Ahead

The last few months have seen stepped up regulatory activity on the worker misclassification front as well as initiatives to enforcement proper payment of wages and other benefits. The SJC also issued two important cases on August 31 dealing with the types of damages available for violations of the Massachusetts Wage Act.

Federal Government Follows Massachusetts Lead in Moving to Joint Agency Information Sharing and Coordinated Enforcement Efforts

Earlier this month, the United States Secretary of Labor and the Commissioner of the Internal Revenue Service signed a memorandum of understanding geared to improve efforts to "end the business practice of misclassifying employees in order to avoid providing employment protections." Seven states, including Massachusetts, also signed memoranda of understanding with the DOL's Wage and Hour Division and in some cases, its Employee Benefits Security Administration, Occupational Safety and Health Administration, Office of Federal Contract Compliance programs, and Office of the Solicitor. Four other states are anticipated to enter into similar agreements in the near future.

These agreements will enable the DOL to share information and coordinate law enforcement with the IRS and participating states. Business models that attempt to eliminate the employment relationship are not inherently illegal, unless they are used to evade compliance with federal labor laws, for example, if an employee is misclassified as an independent contractor and is the denied benefits to which she would otherwise be entitled under the law. These memoranda arose as part of the Misclassification Initiative described in our June 2010 Labor and Employment Alert. That initiative is similar to the the one creating the "Underground Economy and Employee Misclassification Task Force" established by Governor Patrick by Executive Order in March of 2008. See MHTL Spring 2008 Client Alert.

IRS Announces Voluntary Classification Settlement Program

On September 21, 2011, the Internal Revenue Service ("IRS") announced a new program that allows employers voluntarily to reclassify workers previously misclassified as independent contractors, or other non-employees, as employees for federal tax purposes. In entering this program, employers agree to reclassify their workers as employees and agree to treat them as such prospectively. In return, the employer will be subject to limited employment tax liability for the misclassification and not be subject to an employment tax audit for the error.

Part of the IRS's wider "Fresh Start" initiative, the Voluntary Classification Settlement Program ("VCSP") is designed to offer similar benefits to employers as the IRS's Classification Settlement Program ("CSP") for employers currently under IRS examination. The VCSP is an attempt by the IRS to encourage greater compliance with federal tax obligations while avoiding the need for time-consuming and expensive audits regarding the misclassification of employees.

In order to be eligible for this program, employers must meet several requirements:

- Employers must have consistently treated the workers as nonemployees;
- Employers must have filed all required Forms 1099 for the workers in the previous three years;
- Employers must not currently be under audit by the IRS;
- Employer must not currently be under audit for the misclassification of workers by the Department of Labor or any state government agency; and
- Employer must have complied with the results of any previously completed audit by the IRS or Department of Labor.

Under the program, eligible employers who agree to participate will be liable only for 10 percent of the potential employment tax liability on compensation paid to the misclassified workers the previous year, and such liability will be determined under the reduced rates of section 3509 of the Internal Revenue Code. In addition, the employer will not be subject to IRS audit for the misclassification in prior years and will not be subject to any interest or penalties on the liability owed. Employers will be required to extend the period of limitations on the assessment of employment tax liability for the three immediately following calendar years.

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Interested employers may file IRS Form 9852 to apply. Upon review of eligibility, the IRS will contact the employer to complete the process. Should the IRS find the employer eligible, the employer will be required to enter into a closing agreement with the IRS to complete the process and will be required to make full payment of any amount due under the terms of the agreement.

It is important to keep in mind when considering this new program that determining the correct status of workers is a highly fact-specific analysis and that the test used by the IRS is not the same as the test used for most purposes in Massachusetts. Accordingly, you are advised to seek qualified legal advice prior to making a decision to participate in this program.

"There's An App For That": Department of Labor Launch of Mobile App Makes It Easy for Employees to Track Hours

Earlier this year, the Department of Labor ("DOL") launched a mobile application designed to allow employees to track their hours on a real time basis on their smartphones. According to the DOL Wage and Hour Division press release, the app is designed to allow employees to track their hours independently, thereby eliminating the need to rely on employer records alone. The DOL suggests that this new technology could be "invaluable" to employees during a Wage and Hour investigation where the employer has not kept "accurate records."

The application is available in English and Spanish and is currently available for download to an iPhone or iPod Touch. The DOL has indicated that it plans to look into making the app available for other smartphone platforms, such as Blackberry or Android.

Some of the features of the new DOL app include:

- Tracks hours worked and break time, including meals
- Automatically calculates wages owed based on employee input of hourly wage rate
- Tracks overtime at one-and-a-half rate
- Provides summaries of hours worked and wages earned
- Allows employee to email summary timesheet report

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- Provides information about wage laws through links the DOL website and on-screen alerts when a law might have been violated based on information provided

The launch of this app is part of a broader effort by federal agencies to better harness new technology to increase awareness and enforce laws and regulations. Just this past August, for instance, the DOL's Occupational Health and Safety Administration ("OSHA") introduced an app that helps outdoor workers keep track of the heat index and more easily report potential violations to OSHA. Other U.S. government agencies, such as the IRS, Veterans Administration, and FBI, have also recently released apps.

The DOL's new wage and hour app does have limitations. For instance, it has no functionality to take into account a permissible time entry rounding system an employer may use. Additionally, it cannot take into account pay differentials for different shifts or weekend work or account for FLSA exempt employees. It also does not track earned bonuses, commissions, or tips.

Additionally, although the DOL suggests this app will be helpful when there is a wage and hour dispute and an employer has not kept "accurate records," this does not mean that records kept on this app will trump an employer's records when there is a dispute. Boiled down to its basics, the app is essentially a stop watch that records when an employee starts and stops it and then calculates wages based on what the employee inputs as his or her rate of pay. If the employee inputs information incorrectly, or starts or stops the timer at the wrong time, the app will record the wrong information. Indeed, the DOL provides the following disclaimer whenever a timesheet is emailed using the app:

> This App is designed as a reference tool. It does not include every possible situation encountered in the workplace. . . . Further, the conclusions reached by this App rely on the accuracy of the data provided by the user. **Therefore, DOL makes no express or implied guarantees as to the accuracy of this information.**

The single best defense to the problems that may arise from the use by employees of this app is to keep accurate and reliable records. Take the time now to review how time records are kept and what safeguards are in place to ensure accurate reporting. Make sure you are not "suffering or permitting" employees to work when they shouldn't. Be clear in your policies about off-site work. Review overtime practices to ensure compliance with federal and state laws. And, of course, be careful about whom you classify as exempt.

Employers may find it helpful to download and become familiar with the app and its functionality. The app can be found for free download at http://www.dol.gov/whd/.

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SJC Clarifies Consequences of Wage Act Violations in Landmark Independent Contractor/Franchisee Decision

In a landmark case, the Massachusetts Supreme Judicial Court ruled on several Wage Act claims involving a franchisee who claimed he was an employee – and not an independent contractor – of his franchisor. The case has implications well beyond franchising for any employer who may be misclassifying workers as independent contractors.

Background

The case, *Awuah v. Coverall North America*, decided August 31, 2011, involved workers who entered into "janitorial franchise agreements" with Coverall North America, Inc. ("Coverall") for the provision of janitorial services. The workers had sued Coverall in federal court in a class action suit, claiming that they and other similarly situated workers at Coverall were actually "employees" rather than "independent contractors" as the Company claimed. Finding the workers indeed to be employees and not independent contractors, the federal court then certified several questions regarding the Massachusetts Wage Act ("Wage Act") to the Supreme Judicial Court ("SJC") of Massachusetts.

The federal court sought guidance on whether certain pay practices by Coverall relating to the workers now classified as employees were permitted. Specifically, the court wanted to know:

- Whether a franchisor may lawfully use customer accounts-receivable financing to pay a franchisee who is an "employee" – and not an independent contractor – under the Wage Act?

- Whether an employer may lawfully withhold wages to an employee if the employer and employee agree such wages are not earned until a customer provides payment?

- Whether "damages incurred" as a result of the misclassification for which a worker can recover under the Wage Act include those costs an employer must statutorily bear, such as workers compensation insurance?

- Whether an employer and employee may agree that the employee will pay some or all of the cost of workers' compensation or other insurance procured to alleviate employer liability?

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As to whether an employer may use customer accounts-receivable financing to pay its employee franchisees, the SJC decided this was improper under the Wage Act. A customer accounts-receivable financing arrangement withholds payment to the worker until the customer provides payment for the services rendered. The Wage Act, however, specifically requires payment of "wages earned" within a fixed period of time. Though the word "earned" is not specifically defined in the statute, the SJC applied the "ordinary" definition: that is, "to acquire by labor, service, or performance." Thus, the SJC determined that when an employee has completed the work required of him or her, the employee has "earned" the wage and therefore must be paid; accordingly, withholding such payment to an employee until (or if) a customer pays is not allowed.

Similarly, employers and employee-franchisees may not make an agreement to enter into such an accounts-receivable financing arrangement. Indeed, the SJC found that this kind of agreement would violate the "special contracts" provisions of the Wage Act, barring contracts that would exempt an employer from a provision of the Wage Act.

The SJC also decided that "damages incurred" recoverable under the Wage Act include those costs an employer must statutorily bear. Focusing specifically on workers compensation, the Court noted a clear legislative intent in the Massachusetts Workers Compensation Act to put the cost of personal injuries incurred at work squarely on the employer. Thus, a misclassified worker previously classified as an independent contractor and obliged to pay premiums for workers compensation under the terms of the contract may recover those payments as damages when later determined to be an employee under the Wage Act.

The SJC similarly found that payments deducted from a misclassified worker's wages for other "liability" related insurance costs – such as bonding or comprehensive liability insurance – to be recoverable as well. Any such deduction, the SJC held, constitutes damages incurred under the Wage Act which the employee may recover. The SJC also ruled that provisions of contracts which would put the cost of workers compensation and "liability" insurance on the employee may not be enforced. This would violate the Wage Act. The court determined that insurance policy exception in MGL chapter 154, which regulates the assignment of wages, only applies to "employee" insurance policies, such as health, vision, dental or and life insurance, not to insurance policies that operate primarily to insure employers against liability, such as workers' compensation.

Though not specifically certified to the SJC as a question, the Court closed its opinion with a determination on the matter of the legality of "franchise fees" under the Wage Act as applied to employees. The SJC held that under the Wage Act employers may not legally require employees to pay franchise fees as a condition of employment, finding

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that such an agreement between employer and employee would violate public policy. The SJC found that such fees are tantamount to forcing an employee to "buy their jobs" from the employer. Thus, if a worker misclassified as an independent contractor is later found to be an employee, such fees would be recoverable by that employee as "damages incurred" under the Wage Act.

Post-Awuah Ramifications and Recommendations

While the rulings in this case are not unexpected, the ramifications are potentially large for employers with misclassified employees. Misclassification of workers as independent contractors can have serious ramifications as it relates to owed employment tax at the federal and state level, subjecting an employer to back taxes and penalties. ERISA and state benefits law obligations turn on the distinction as well. This case clarifies and expands liability on a different front – under the Massachusetts Wage Act. It also makes clear that agreements between employers and its employees that violate the Wage Act are unenforceable and lead to a wide variety of recoverable damages, including money paid out for workers compensation and other "liability" insurance, as well as franchise fees. Accounts receivable financing arrangements will be nullified as well and the formerly classified independent contractors (now employees) will be owed wages within the statutory timeframe, regardless of whether payment for the work has been received from the end customer.

There is no time like the present to examine carefully and assure yourself of the proper classification of each of the individuals who work for you in any capacity. Remember that under the Massachusetts law, it is much more difficult to categorize a worker as non-employee that it is under either federal law or in many states. Also remember that the determination is highly fact-specific and that a worker could be an employee for one purpose but a contractor for another. This confusing hodgepodge makes it critical to seek appropriate advice once you have done your own preliminary analysis.

2008 Mandatory Treble Damages Law Not Retroactive

Prior to a 2008 Wage Act amendment, costs and reasonable attorneys' fees were mandatory as part of a prevailing claimant's award, but the decision to award treble damages was left to the discretion of the trial judge. Treble damages, being punitive in nature, were generally considered appropriate where the employer's conduct was "outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others."

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Effective July 12, 2008, however, the Wage Act was amended to make treble damages mandatory for prevailing Wage Act claimants. In another wage case, *Rosnoy v. Molloy*, decided the same day as *Awuah*, the SJC ruled that the 2008 amendment to the Wage Act making treble damages mandatory for prevailing Wage Act claimants was not to be applied retroactively. Accordingly, claims arising prior to July 12, 2008, will be considered under the preexisting law. Accordingly, the decision as to whether to award treble damages will continue to be at the judge's discretion for conduct occurring prior to July 12, 2008.

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If you have any questions or concerns with regard to this alert, please contact Attorney Katherine Hesse, the attorney assigned to your account, or your own labor & employment counsel.

Murphy, Hesse, Toomey & Lehane, LLP, is a multi-service law firm with offices in Quincy, Boston, and Springfield, Massachusetts. The firm emphasizes labor & employment law, employee benefits law, municipal law, public sector labor law, education law, special education law, and related litigation.

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