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Misclassifying employees as independent contractors could prove costly for city

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Needing workers to assist with the business is an almost certain eventuality as a company grows. The first and probably most important question an employer asks itself is whether the worker should be classified as an employee or an independent contractor. Whether a worker is an employee or an independent contractor isn't determined by the label placed on him in a contract. Instead, the determination hinges on several factors that make up the economic realities of the relationship.

Background

Joan Smith and Roberta Tate worked as resident assistants (RAs) at Pine Tower, a senior housing facility owned and operated by the city of Phoenix. Both RAs signed a "Tenant Resident Assistant Agreement" each year that stated they were independent contractors, not employees of the city. The agreement also included a list of services to be performed by the RAs as well as a schedule on which the services were to be performed between 8:00 a.m. and 5:00 p.m. Monday through Friday every other week.

The RAs had to remain on the property when they were on duty. They were also required to perform services in addition to the services listed in the agreement, such as delivering monthly rent statements and other notices to tenants, signing contractors in and out, and monitoring the property for unauthorized persons. In exchange for their services, the RAs received a rent-free apartment and a monthly stipend of $200.

The RAs sued the city, asserting that they were improperly classified as independent contractors when they should have been classified as employees. Consequently, they asserted, the city violated the Fair Labor Standards Act (FLSA) by not paying them minimum wages and overtime during their relationship. The RAs asked the U.S. District Court for the District of Arizona to rule that they were employees, not independent contractors, and the court agreed.

Independent contractors? No

In determining whether the RAs were independent contractors or employees, the court reviewed the economic realities of the relationship and applied several determinative factors. The court found that based on the totality of the circumstances, the RAs were employees, not independent contractors.

First, the court assessed the degree of the city's control over the RAs. While the city didn't exert total control over their work, the list of services in the contract and the additional tasks assigned by managers demonstrated the level of control an employer would typically have over an employee. The RAs didn't need specific tools or equipment, nor did they need special skills to complete their tasks for the city.

Moreover, there was "a high degree of permanence in the working relationship," even though the city required the RAs to sign a new contract each year. Smith had worked as an RA for nearly seven years, and Tate had worked as an RA for more than three years.

Volunteers? No

The court quickly disposed of the city's alternative argument that the RAs were volunteers, not employees. The court looked to the FLSA's definition of "volunteer" as "an individual who performs hours of service for a public agency for

civic, charitable, or humanitarian reasons, without promise, expectation or receipt of compensation for services rendered." Although volunteers may be paid for expenses or receive a nominal fee, the remuneration cannot be tied to productivity or be a substitute for compensation.

In this case, the RAs received more than a nominal amount for the services they performed, and the court held that they couldn't be volunteers under those circumstances. They received $2,400 per year in stipends plus free rent, which amounted to more than $3,000 annually. That amount, according to the court, represented compensation, not reasonable benefits or nominal fees.

Impact of misclassification

The court classified the RAs as employees, entitling them to the protections of the FLSA. The resulting liability for the city will consist of back pay to compensate the RAs for minimum wages they should have been paid and any overtime they worked. The FLSA also provides that the employees will be entitled to liquidated damages in an amount equal to the unpaid wages. Finally, the city will be responsible for the attorneys' fees incurred by the RAs in bringing their claims against the city. Those are just some of the risks to consider when you classify workers as independent contractors instead of employees.

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