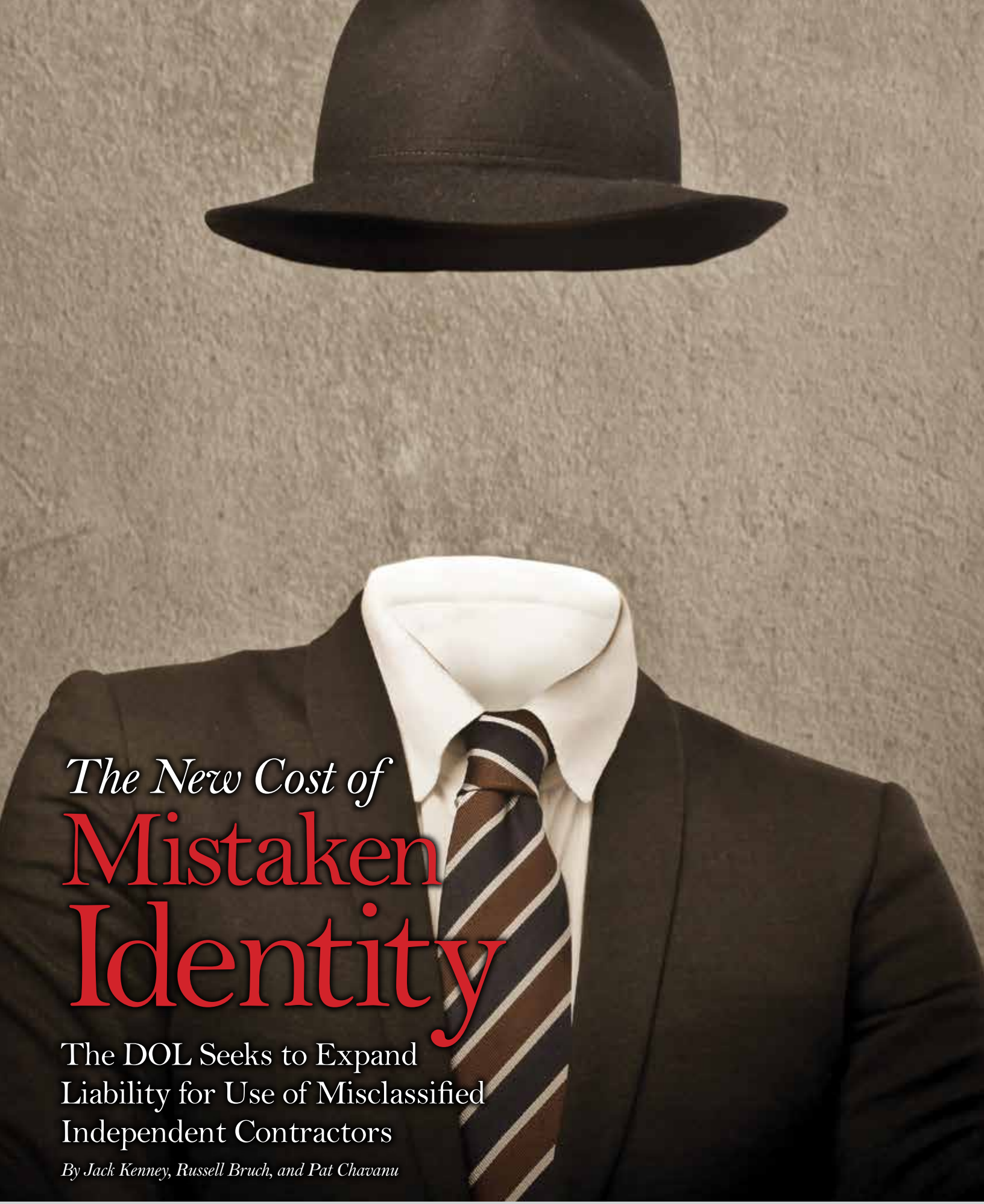

The New Cost of Mistaken Identity

The DOL Seeks to Expand Liability for Use of Misclassified Independent Contractors

By Jack Kenney, Russell Bruch, and Pat Chavanu

The workers' compensation industry currently employs a significant number of independent contractors, particularly in medical case management. However, there are recent developments regarding the classification and misclassification of independent contractors that the industry must be aware of, as it may have far-reaching implications for the future picture of risk and liability.

Here is the way the new developments break down. The U.S. Department of Labor (DOL) views the misclassification of employees as independent contractors as one of the most serious problems facing affected workers, employers, and the entire economy.

To fight this problem, the DOL has instituted an ongoing initiative aimed at ending the business practice of misclassifying workers as independent contractors to avoid paying certain wages, benefits, and taxes. As part of this initiative, the DOL has teamed with a number of agencies, including the Internal Revenue Service (IRS), to share information and coordinate enforcement to ensure that workers are properly classified.

The workers' compensation industry must realize that the DOL means business in this regard, as it has issued an administrator's interpretation aimed at expanding liability under the Fair Labor Standards Act (FLSA). This guidance, which was issued in July 2015, could eliminate independent contractor status for many workers in the medical management field. Additionally, in January 2016, the DOL issued guidance that seeks to expand joint-employer liability and potentially impose liability on companies that hire vendors that use workers improperly classified as independent contractors.

What does this mean for workers' compensation? The DOL's misclassification initiative, and specifically its administrator's interpretations, could affect insurers, third party administrators (TPAs) and self-insured employers in the medical case management industry that hire independent contractors directly or engage vendors using independent contractors. At a minimum, the DOL guidance will provide ammunition for plaintiff's lawyers seeking to hold deep-pocket payers and TPAs liable under the FLSA (and perhaps state law) for wage and hour violations, including overtime pay.

Given the increased risks associated with the DOL's expansive interpretation of the law, workers' compensation companies should seek legal advice to make sure their workers, and their vendors' workers, are properly classified and to examine their vendor relationships to reduce potential risk.

In this article, we will delve into each of the changes in order to provide workers' compensation organizations with a deeper understanding of the issues involved, what they need to be aware of, and what steps they can take to minimize their risk under these new developments.

Aggressive Interpretation of Independent Contractor Classification

First, it is important for workers' compensation organizations to understand which workers can and cannot be classified as independent contractors under the new guidelines. On July 15, 2015, the DOL issued an administrator's interpretation setting forth the test that it will apply in determining whether an individual qualifies as an independent contractor or an employee. In the administrator's interpretation, the DOL stated that individuals who are "economically dependent" on an employer should be treated as employees.

With this in mind, workers' compensation organizations should have their legal counsel review the administrative interpretation and consider the factors listed by the DOL in determining whether a worker should be classified as an independent contractor or an employee. For example, in workers' compensation managed care, organizations should apply this DOL guidance in evaluating their use of case managers as independent contractors.

The DOL's guidance stated that, in applying its independent contractor test, it would take the position that the FLSA should be construed liberally to provide broad coverage such that most workers are considered employees under the FLSA. For example, in looking at whether a worker, such as a nurse case manager, should be classified as an employee or an independent contractor, it is the DOL's position that working off-site, controlling one's own hours, and having little supervision are not "indicative of independent contractor status."

Although the administrator's interpretation is not a formal regulation and, thus, not binding on employers or the courts, it does reflect the DOL's enforcement position. This means that DOL investigators will be guided by this expansive take on who should be classified as an employee or independent contractor. Additionally, although courts have developed their own tests for determining who is properly classified as an independent contractor, courts often look to the DOL's guidance in applying the FLSA. The plaintiff's bar also is certain to use the position advanced by the DOL in lawsuits brought by allegedly misclassified workers.

Consequently, the administrator's interpretation presents an added risk to workers' compensation companies that use case managers classified as independent contractors. If a worker is found to be an employee rather than an independent contractor, the liability can include civil penalties, unpaid wages, claims for employee benefits, and exposure under applicable tax and workers' compensation laws.

In short, the DOL's guidance regarding independent contractors should prompt companies in the medical case management industry—particularly those that use independent contractors or vendors that use independent contractors to provide key aspects of their case management services—to review their classification of independent contractors and vendor relationships in light of the increased risk.

Expanded Interpretation of Joint-Employer Liability

Currently, organizations in the workers'

compensation industry may think they are in the clear if they do not directly employ independent contractors. Unfortunately, this thinking may be faulty. These organizations still may be on the hook for misclassified independent contractors who are employed by service providers due to an expanded interpretation of joint-employer liability.

On Jan. 20, 2016, the DOL issued an administrator's interpretation seeking to significantly expand the circumstances under which companies can be found to be joint employers with their vendors.

The DOL's new guidance is a significant departure from the traditional joint-employer analysis used by most courts, where control over an employee—whether directly by power over physical performance or indirectly through other means (such as through a vendor)—is necessary to impose joint-employer liability under the FLSA. In contrast, under the DOL's new guidance, even in situations where little to no traditional indications of control can be shown to exist between two entities, the DOL would require an analysis of the "economic reality" of the situation.

This change in approach could impose FLSA liability on insurers, employers, and TPAs that engage vendors using misclassified independent contractors. Consequently, legal counsel for these workers' compensation companies should review this administrative interpretation and consider the factors listed by the DOL in determining whether their company is at risk of being deemed a joint employer with its vendors that use case managers classified as independent contractors.

Through this administrator's interpretation, the DOL is clearly seeking to expand the scope of joint-employer liability so that "larger and more established" companies can be found as joint employers. This is consistent with public statements by the administrator of the DOL's Wage and Hour Division advocating that larger employers should be responsible for ensuring the compensation and economic well-being of workers they do not employ.

If a company, such as a workers' compensation insurer or TPA, is found to be a joint employer, it can be held jointly and severally liable with its vendor for resulting damages under applicable wage and hour, tax, and workers' compensation laws. Thus, workers who are not properly paid wages or benefits by the company that employs or contracts with them directly (e.g., those improperly classified as independent contractors) may seek to recover compensation from a "deep pocket" joint employer that is the ultimate recipient of the benefits of their work.

In light of this increased risk, companies in the workers' compensation space should not only analyze their own use of independent contractors, but also should pay increased attention to the use of independent contractors by their vendors.

Although there is uncertainty about whether and how judges will receive the DOL's new standard regarding joint employers, the plaintiff's bar surely will seize upon the language in the administrator's interpretation, hoping to convince courts to find deeper-pocket companies liable for a vendor's misclassification of its workers.

With these risks in mind, companies should prepare to defend against potential suits and reevaluate their vendor relationships with the view that the DOL's new "economic realities" test could be applied. Given the structure and amount of oversight required in the medical case management industry, companies that outsource case management work should be particularly mindful of the DOL's position and consider steps to make sure that their vendors properly classify and pay their workers in order to reduce any potential liability in the event of a joint employment finding.

The DOL's Misclassification Initiative

Organizations in the workers' compensation industry must realize that the DOL's guidance in the above-referenced administrator's interpretations is just part of a broader initiative. Recognizing that employee misclassification generates losses to states and the federal government in the form of lower tax revenues, as well to state unemployment and workers' compensation funds, the DOL is reaching out to other state and federal agencies to help it curb employee misclassification.

Specifically, the DOL has entered into cooperation agreements with federal agencies such as the IRS, Employee Benefits Security Administration, Occupational Safety and Health Administration, Office of Federal Contract Compliance Programs, and Office of the Solicitor. It also has partnered with 29 states to work to end employee misclassification. These agreements and partnerships allow the agencies to share information and coordinate their enforcement efforts.

For example, in its memorandum of understanding with the DOL, the IRS agreed, consistent with applicable law, to provide the DOL with data and information that may constitute evidence of a violation of a law that the DOL enforces. Likewise, the DOL agreed, consistent with applicable law, to share investigation information and other data with the IRS that it believes may raise employment tax compliance issues. The IRS promised to use the information provided by the DOL to determine compliance with employment tax laws. This is significant for organizations in the workers' compensation industry because the IRS arguably is more active and aggressive in its independent contractor audits and often imposes multimillion-dollar tax assessments.

In short, this coordinated enforcement effort by the DOL and other state and federal agencies is likely to create increased challenges for organizations in the workers' compensation industry that utilize workers classified as independent contractors. Therefore, it is incumbent upon these businesses to understand the risks involved and to take some of the steps outlined in this article to mitigate their exposures. ■

Jack Kenney is a shareholder with Hangley Aronchick Segal Pudlin & Schiller, Russell Bruch is of counsel with Morgan Lewis, and Pat Chavanu is senior vice president with Genex Services.