

# Considerations When Reclassifying Independent Contractors

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Recent court cases in California (e.g., *Dynamex Operations West v. Superior Court*<sup>1</sup>) activity by the US Department of Labor<sup>2</sup> regarding what constitutes a legitimate independent contractor working relationship have led some companies to reconsider their current relationships with their workers. Some companies have made the decision to “reclassify” their independent contractors as hourly employees. Examples of gig economy companies that have reclassified their workers as employees include: Honor, Instacart, Zirtual, Shyp, Hello Alfred, Munchery, Eden, and Luxe.<sup>3</sup> Reportedly, success for some of these companies after the change has been mixed.<sup>4</sup>

Reclassification of workers and employees can be a com-

plex process because it impacts not just the individual job being reclassified, but also different systems and structures throughout the organization. The most significant change for workers may be the fact that as employees, they are now covered by the Fair Labor Standards Act and are therefore entitled to additional pay for overtime hours worked, among other protections. In addition, as employees, these workers have access to company support structures and processes that may exist, such as human resource services.

Providing employees with internal services and management can result in additional expenses for the business and increased operational complexity. An organization should evaluate these chal-

lenges before making changes to classification. An employer’s ability to anticipate and address these challenges in advance can have a large impact on the success of the reclassification process. Below, I highlight some processes that may be impacted when organizations make the decision to change their independent contractors to employees.<sup>5</sup>

## 1. Labor Hours and Scheduling Work

One advantage to working with independent contractors, from a company’s perspective, is that they can be “on demand” based on the needs of the business. This flexibility in staffing can be financially advantageous to many companies and may actually be es-

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essential to some gig economy company business models.

When independent contractors are converted to employees, their work schedule typically cannot be modified as quickly, and the business must carry the expense of compensating employees for time worked regardless of customer flow and production. This expense can be significant and has been cited as the primary reason why some gig-economy companies that have reclassified have gone out of business.<sup>6</sup>

The creation and ongoing management of employee work schedules can require a significant investment of company time and resources. While increasingly sophisticated software can facilitate balancing the range of variables that need to be taken into account when creating an employee work schedule (such as expected customer demand, employee availability, and available labor hours), each work schedule has to be actively managed as the reality of the work day plays out. In many industries, an employee work schedule is subject to frequent modification because of employee call-outs and unexpected peaks in business. Depending on location, however, an employer's ability to react and actively modify em-

ployee work schedules may be limited. Some jurisdictions have notice requirements regarding posting work schedules and providing employees with advance notice of any changes.<sup>7</sup> Predicting customer demand, accommodating employee needs, and modifying work schedules appropriately to maintain an appropriate balance of staff and maintain profitability can be an ongoing challenge for employers in some industries.

## 2. Time Tracking

An employer is responsible for tracking actual work hours and breaks (depending on location) taken by hourly employees. Compliance with time tracking involves implementing a time-tracking mechanism (such as a time-clock) or integrating a program into an existing point of sale (POS) register or computer. For hourly employees, any work beyond eight hours a day or forty hours a week (depending on location) will result in overtime pay. Paying 1.5 times an hourly rate can have a significant impact on labor costs, and many businesses try to avoid incurring this expense. Avoiding overtime payments requires a thorough and dynamic scheduling process (as described above).

Employee work hours must

be recorded and then reviewed, and deviations from the expected work hours must be explained and accounted for. A formalized process to guide this review and handle exceptions consistently and appropriately should be developed to avoid claims of mishandling.

Depending on the nature of the business, companies may consider evaluating whether there are any pre-clock-in or post-clock-out compensable activities that employees are required to perform when starting and ending their shifts (e.g., unlocking store, turning on/off alarm). Recent case law in some states suggests that the duration of these activities should be noted by employers and in some cases may be compensable.<sup>8</sup> It may therefore benefit employers to be aware of such activities and to have a reliable assessment of how much time these tasks take to complete.

## 3. Redefined Job Responsibilities

Unlike when working with independent contractors, employers have the ability to actively manage employees' work and monitor productivity. With these changes, some employers may decide to modify the scope of responsibilities associated with a particular job.

For example, giving employees accountability for managing others can be added to the job. In addition, involvement in activities that benefit the business overall, such as the identification and selection of new staff, can be assigned to hourly employees.

When the tasks and responsibilities of a job change, modifications are likely required to related materials, such as job descriptions, selection criteria, training content, and performance criteria, some of which are addressed below.

### 4. Training

Policies, procedures documents, and training materials must be developed to guide employees on how to perform new job tasks, such as time-clock procedures. To the extent any job responsibilities are modified and new performance expectations are developed, training must be provided to clearly articulate their importance.

Compliance with internal procedures, such as time-clock procedures, meal and rest breaks, and safety guidelines, is important for employers to ensure that employees are safe and to avoid the risk of violation penalties. To encourage new rule adoption, all employees, including management, can be held accountable

for hourly employee compliance. Integrating this accountability into performance measures may reinforce its importance.

Preparing and distributing internal communications explaining why the reclassification has been done and what these changes mean for the company is an important step for employers with any organizational change effort. Organizational change can cause stress for employees, and frequent, consistent internal messaging is one action that can minimize it.

### 5. Performance Management and Control

Companies can actively dictate how and when services are provided and manage the performance of employees. Clear expectations around *how* to provide services, as well as management of the outcomes of work, can be communicated and enforced. The company can dictate the sequence and manner in which services are provided and impose consequences for deviations from these expectations. This level of monitoring can increase the consistency and quality of service provided to customers, which can be beneficial to the business. This has been noted by some companies as one of the primary drivers behind their reclassification.<sup>9</sup>

### The Employee's Perspective

Reclassification can result in meaningful job changes from an employee's perspective. As noted above, new expectations around work hours and availability are likely. As a consequence, pay rates may change. New compensation may also be available from the company in the form of benefits and other non-monetary offerings. Unlike compensation models based solely on production, the hourly employee receives a minimum hourly rate regardless of performance. This can make income more stable and predictable, which some workers may find preferable to the inconsistency often associated with working as a contractor.

The support that the company can provide for employees may be perceived as a positive change for some workers. Receiving guidance and instruction on how to perform specific activities, and having a designated person or department to go to (e.g., manager, human resources) as questions or problems arise, can make it easier for some employees to perform their work effectively.

In contrast, some hourly employees may struggle with the lack of flexibility in their work hours and the need to commit



in advance to working specific hours. Having accountability to a specific manager may create additional structure and may reduce workers' independence. Having a direct supervisor and being held to

defined performance standards may be interpreted as restrictive for some workers who had the freedom associated with contracting. Further, changes in work responsibilities may require new training and learn-

ing, which some workers may not want.

A summary of potential implications for employers and employees is included in Table 1.

**Table 1: Potential Implications for Employers and Employees**

Employers	Employees
<ul style="list-style-type: none"> <li>● Labor hours and work schedules <ul style="list-style-type: none"> <li>○ Adjustments to labor budgets</li> <li>○ Changes to work scheduling (e.g., total labor hours, number of employees)</li> </ul> </li> <li>● Time tracking <ul style="list-style-type: none"> <li>○ Changes to timekeeping and payroll systems</li> </ul> </li> <li>● Training <ul style="list-style-type: none"> <li>○ Updates to company policies (e.g., clocking in/out, meal and rest breaks)</li> <li>○ Internal messaging regarding the changes</li> <li>○ Increased standardization</li> </ul> </li> <li>● Redefining job responsibilities <ul style="list-style-type: none"> <li>○ Revisions to job descriptions, selection criteria, training content</li> </ul> </li> <li>● Performance management and control <ul style="list-style-type: none"> <li>○ Dictate how work is executed</li> <li>○ Monitor employee task execution</li> </ul> </li> <li>● Legal Implications <ul style="list-style-type: none"> <li>○ Impact on frequency of litigation <ul style="list-style-type: none"> <li><input type="checkbox"/> Decreased risk of litigation related to misclassification</li> <li><input type="checkbox"/> Possible increased risk of litigation related to: Missed meal and rest breaks <ul style="list-style-type: none"> <li>● Off-the-clock work (security checks, working from home, walking time, donning and doffing, compensable activities off the clock)</li> <li>● Timekeeping system issues (e.g., rounding, time shaving)</li> </ul> </li> </ul> </li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● Changes in hours worked <ul style="list-style-type: none"> <li>○ Reduced flexibility</li> <li>○ Commitment to schedules in advance required</li> <li>○ Reduced accessibility "after-hours"</li> </ul> </li> <li>● Changes in compensation <ul style="list-style-type: none"> <li>○ Overall pay</li> <li>○ Benefits</li> <li>○ Employee protections (e.g., overtime pay, workers comp)</li> </ul> </li> <li>● Additional procedures and policies to learn and follow (e.g., clocking in/out, meal and rest breaks)</li> <li>● Changes to job responsibilities</li> <li>● New metrics and performance management expectations <ul style="list-style-type: none"> <li>○ Increased accountability</li> </ul> </li> <li>● Reduced autonomy</li> <li>● Impact on employee morale and organization culture</li> </ul>

## SUMMARY

Reclassifying workers is a multifaceted process that can have a notable impact throughout an organization. While legal risk may be reduced with respect to independent contractor status, new compliance

challenges may be created by employing hourly employees. Modifications to internal structures and systems in advance of any change may be required to ensure that new expectations are clearly communicated and followed by new hourly employees. To ensure ongoing

compliance, an audit program can also be established to monitor employee behavior. Before making any reclassification decisions, it is advisable to seek legal guidance.

*The views and opinions expressed in this article are those*

of the authors and do not necessarily reflect the opinions, position, or policy of Berkeley Research Group, LLC or its other employees and affiliates.

## NOTES:

<sup>1</sup>Dynamex Operations West v. Superior Court, 4 Cal.5th 903416 P.3d 1232 Cal.Rptr.3d 1 (2018).

<sup>2</sup>Examples include signing a new Memorandum of Understanding with the New Jersey Department of Labor and Workforce Development on August 10, 2018, to increase enforcement of independent contractor misclassification; and issuing a new Field Assistance Bulletin, "Determining Whether Nurse or Caregiver Registries are Employers of the Caregiver" (July 13, 2018).

<sup>3</sup>A. Kamdar, "Why some gig economy startups are reclassifying workers as employees," *OnLabor Workers, Unions, Politics* (February 19, 2016), available at <https://onlabor.org/2016/02/19/why-some-gig-economy-startups-are-reclassifying-workers-as-employees/>; M. Kosoff, "\$2 billion grocery delivery startup Instacart is reclassifying some of its workers as employees," *Business Insider* (June

22, 2015), available at: <http://www.businessinsider.com/why-instacart-is-reclassifying-some-of-its-workers-as-employees-2015-6>; S. Faulman, *Worker vulnerability in the "gig economy,"* paper presented at the annual conference of the American Bar Association, Washington, DC (April 2016), available at: [http://www.americanbar.org/content/dam/aba/events/labor\\_law/2016/04/tech/papers/gig\\_economy\\_faulman.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/events/labor_law/2016/04/tech/papers/gig_economy_faulman.authcheckdam.pdf); and Rick Wartzman, "Why Hello Alfred Is Focused More On Its Workers And Less On Algorithms," *Fast Company* (October 27, 2017) available at: <https://www.fastcompany.com/40485016/why-hello-alfred-is-focused-more-on-its-workers-and-less-on-algorithms>.

<sup>4</sup>For example, virtual assistant startup Zirtual reclassified its contractors but ran into financial trouble as operating costs increased, while Eden, an office management platform, reclassified and continued to grow. See J. Crook, "Eden, Offering On-Demand Tech Help, Switches From Contractors To W2 Employees," *TechCrunch* (August 3, 2015), available at: <https://techcrunch.com/2015/08/03/eden-offering-on-demand-tech-help-switches-from-contractors-to-w2-employees/>.

<sup>5</sup>This list is not comprehensive, and, as every organization is unique, the specific details of this process may vary by company.

<sup>6</sup>For example, home healthcare startup HomeHero reclassified independent contractors to employees but ran into financial trouble after its onboarding costs increased significantly; see Miranda Katz, "These Startups Are Ditching the Uber Model and Hiring Full-Time Workers," *Wired* (April 7, 2017), available at: <https://www.wired.com/2017/04/these-startups-are-ditching-the-uber-model-and-hiring-full-time-workers/>.

<sup>7</sup>For example, see the City and County of San Francisco's Office of Labor Standards Enforcement, "Formula Retail Employee Rights Ordinances," available at <https://sfgov.org/olse/formula-retail-employee-rights-ordinances>.

<sup>8</sup>See, for example, Douglas Troester v. Starbucks Corp., 5 Cal.5th 829421 P.3d 1114235 Cal.Rptr.3d 820 (2018) in the Supreme Court of the State of California.

<sup>9</sup>See, for example, Honor (Tim Mullaney, "Honor to Directly Employ Home Care Workers," *Home Health Care News* (January 19, 2016), available at: <https://homehealthcarenews.com/2016/01/honor-to-directly-employ-home-care-workers/>) and Shyp (Katz 2017), both startups that started with an independent contractor model and reclassified their workers to employees.