EMPLOYMENT LAW NEWS

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IN THIS ISSUE

Employment Law Practice Group

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The Perils of Misclassifying Employees as Independent Contractors

- *Summary:* There is movement afoot by the government to crack down on employers who have misclassified employees as independent contractors. Because there are significant penalties for violations, and costs associated with audits, companies should take the time to carefully examine the relationships they have with anyone classified as an independent contractor. If there is any doubt as to whether an individual is properly classified, the company should contact employment counsel to review the various government tests used to determine employee/independent contractor classification. If it is determined that an individual is properly classified as an independent contractor, the company should be certain that the relationship is documented in a well-drafted consulting agreement which clearly describes the nature and limitations of the relationship between the parties and contains all appropriate representations from the independent contractor.

Full article on page 2.

New York Court Upholds Retaliation Claim Based on Overtime Complaint

- *Summary:* In August, a New York trial court held that employees who complain about overtime are protected from retaliation by their employers. Accordingly, employers need to take overtime complaints seriously and investigate them promptly and thoroughly. Consider conducting a review of your overtime policies and employee classifications as exempt or non-exempt. Additionally, before taking any adverse action (such as a demotion, pay decrease, suspension, discipline, reassignment, termination and the like) against any employee who has complained about the failure to receive overtime, consult with employment counsel.

Full article on page 3.

Deductions From Wages to Recoup Overpayments, Advances and Repayment of Loans are Unlawful Deductions Under §193 of the New York Labor Law

- *Summary:* The New York State Department of Labor recently reiterated that deductions from wages to recoup overpayments, even with the express written consent of an employee, violate the Labor Law. This position extends to advances of salary and repayment of loans. Employers should review their polices regarding deductions from amounts due to employees to ensure that such policies do not allow for impermissible deductions, regardless of whether such deduction has been authorized by the employee. Policies may include notice to employees that they are responsible for notifying their employer if they receive an overpayment and if the employee fails to do so, disciplinary action may be taken. If an employer needs to request repayment of an overpayment, advance or a personal loan, however, the request to repay must expressly state that the employee's refusal to comply will not result in any disciplinary or retaliatory action. Lastly, in light of the limitations discussed above, employers may want to reconsider their policies in respect of granting personal loans, salary, bonus, paid leave or tuition advances to employees.

Full article on page 4.

The Perils of Misclassifying Employees as Independent Contractors

In this period of economic uncertainty, many employers have sought to cut costs by retaining independent contractors as an alternative to adding additional employees to their payroll. By classifying a worker as an independent contractor rather than an employee, the employer avoids withholding taxes and paying payroll taxes, such as Social Security, Medicare and unemployment insurance, benefits, and other related costs associated with an employee.

This increase in independent contractor classification is shrinking the amount of payroll taxes paid to the federal and state governments and to their various agencies, who are faced with having to pay out unemployment benefits to individuals at an increased level due to the high unemployment rate. In fact, experts estimate that misclassification of workers as independent contractors costs the federal government approximately $2.7 billion each year in reduced tax revenue. Consequently, in an effort to boost the revenue stream to the governments' strained coffers, the Internal Revenue Service ("IRS"), and the federal and various state Departments of Labor ("DOL"), are cracking down on companies that have misclassified employees as independent contractors.

Employers who are found liable for misclassifying employees as independent contractors face significant tax liabilities and penalties for failing to withhold or pay associated payroll taxes. Misclassification also can result in claims by employees that they should have been entitled to benefits, including group health insurance and/or the ability to contribute to a 401k plan. Further, employees who are misclassified as independent contractors could complain that they are entitled to overtime. As a result of recent case law (see article on page 3), employers cannot retaliate against such employees which constrains employers' ability to discipline or terminate underperforming employees.

The Government's Plan of Action

President Obama, in his 2011 budget, proposed a joint taskforce of the IRS and DOL to aggressively pursue independent contractor misclassification. The federal DOL has earmarked $25 million of its 2011 budget towards this misclassification initiative and also plans to hire approximately 100 additional investigators who will be tasked with targeting employers who misclassify employees as independent contractors. Earlier this year, the IRS began conducting random employment tax audits and it plans to continue to conduct these audits of several thousand companies each year through 2013.

Further, the Employee Misclassification Prevention Act ("EMPA"), which targets abuses of employee/independent contractor classification was reintroduced this past April and is currently pending before Congress. This bill is aimed at ensuring that workers are properly classified as "employees" under the broad definition of that term under the Fair Labor Standards Act ("FLSA"). By increasing the number of workers classified as employees, the government can ensure that workers are eligible for minimum wage, overtime and other statutory protections and can increase the government's tax revenue through payroll tax withholdings and other related payments. Among the numerous proposed changes in the bill are new requirements for employers to keep current records reflecting the accurate status of each worker. The bill also provides for an increase in existing penalties in the event of misclassification. For instance, under the pending bill, employers may be charged civil penalties of $1,100 per employee for first-time offenders, and up to $5,000 per employee for repeat or willful offenders. Further, if an employer is found to have both improperly classified a worker as an independent contractor, and violated the minimum wage or overtime provisions of the FLSA, that employer may be subject to double liquidated damages.

At the state level, companies should be aware that the state DOLs have the authority to audit payroll records when a violation is suspected, or at random. Like the federal DOL, the state DOLs have also increased the number of audits conducted and are focusing in particular on this misclassification issue.

What Should Companies Do to Limit Their Exposure?

Since this has become such a "hot button" issue at both the federal and state levels, it is prudent for companies to take some time to "self-audit" their workforce to determine if their workers are properly classified. Unfortunately, this task is easier said than done. The lack of a universal definition of "employee" often presents challenges for a company that is seeking to properly classify a worker. While the IRS has historically used a "20 Factor Test" for determining a worker's proper status, when conducting an audit, the New York State DOL has historically applied its own five part test, known as the "economic reality test."

Despite the fact that there is no clear black and white definition of "employee," or one determining factor among the many to be considered, the most important facet of the relationship to be examined is the degree of control that the company has over the individual. If a company has retained an individual as an independent contractor, the company should analyze the degree of control that it has over such individual to determine if he/she has been properly classified. Factors to consider include: (1) who sets the hours of work and the manner in which the task will be completed; (2) whose equipment is being used to complete the tasks required; (3) where is the work being performed; (4) was the rate and method of payment negotiated; and (5) is the individual free to work

for others during the consulting period. The more autonomy the individual has over things like how he/she completes the work, when the work is completed, where he/she works and if the rate and method of pay was negotiated, the more likely that individual will be deemed properly classified as an independent contractor. Conversely, if an individual is being directed by the company, has set hours, is working using company equipment on company premises and is paid on the same schedule as the company's employees at a rate pre-determined by the company, the more likely that individual will be found to be an employee.

Additionally, a company should be particularly wary of entering into a consulting relationship for a lengthy or indeterminate period of time, as such a relationship will often arouse government suspicion of misclassification. Similarly, consulting relationships between a company and a former employee will also be subject to increased scrutiny, particularly if the consultant is not permitted to work elsewhere during the consulting relationship.

New York Court Upholds Retaliation Claim Based on Overtime Pay Complaint

On August 12, 2010, in *Ji v. Belle World Beauty, Inc.*, Index No. 603228/2008, 2010 NY Slip Op 32166U; 2010 N.Y. Misc. LEXIS 3825 (Sup. Ct. New York County, Aug. 12, 2010), Judge Emily Jane Goodman of the Supreme Court of the State of New York, New York County, sustained a claim for retaliatory discharge under New York Labor Law § 215 arising out of an employee's complaint about overtime wages. The decision rejects a Second Department case, *Epifani v. Johnson*, 65 A.D.3d 224, 882 N.Y.S.2d 234 (2d Dep't 2009), that refused to sustain such a claim because the Labor Law does not contain any provisions specifically concerning overtime compensation.

In *Ji*, two employees of a nail salon in Manhattan alleged that they worked over ten hours every day, six days a week, but did not receive proper overtime wages. The employees complained to their employer about its failure to pay overtime, and the employer discharged the employees shortly thereafter. The employees sued the employer, alleging, among other things, that the employer violated Labor Law § 215 by discharging them in retaliation for complaining about overtime pay. The employer moved to dismiss the retaliation claim for failure to state a claim, among other things, relying on *Epifani*.

Labor Law § 215 prohibits, in pertinent part, a discharge in retaliation for complaining that the employer has violated a provision of the Labor Law, and confers upon plaintiffs a private right of action against employers who have violated the section. Although the Labor Law itself does not contain any provision concerning the payment of overtime wages, the New York Department of Labor has promulgated regulations directing employers to pay overtime wages. *See* 12 N.Y.C.R.R. 142-2.2.

The court in *Ji* noted that both federal and state courts have upheld a plaintiff's claims to enforce their overtime rights under 12 N.Y.C.R.R. 142-2.2. The court further noted that the Labor Law itself granted authority to the Commissioner of Labor to issue regulations governing any provision of this Chapter. Thus, the court concluded "[i]t is senseless to conclude that the legislature directed the Commissioner to enforce the Labor Law, and empowered the Commissioner to do so through regulation, yet did not also intend that such regulations would be given the full force of law, including the full force and effect of Labor Law § 215." 2010 N.Y. Slip Op 32166U at * 18.

The *Ji* court declined to follow *Epifani*, which is not binding on courts in the First Department, noting that the *Epifani* court did not even consider the overtime regulation in its analysis. *Id*. In *Epifani*, the Second Department held that to state a claim for retaliation under Labor Law § 215, an employee must allege a specific violation of the Labor Law. Therefore, because the Labor Law did not contain a specific provision concerning overtime pay, the court concluded a retaliation claim based on a violation of overtime rules cannot stand. *See* 65 A.D.3d at 236.

Ji reminds employers in New York to take seriously employee complaints concerning overtime pay, and investigate such complaints promptly and thoroughly. Employers should also recognize that taking adverse action against an employee who has previously complained about overtime pay presents a litigation risk, and should consult with counsel in advance of taking any action.

Deductions from Wages to Recoup Overpayments, Advances and Repayment of Loans are Unlawful Deductions from Wages Under §193 of the New York State Labor Law

Section 193(1) of the New York State Labor Law prohibits an employer from taking deductions from the wages of an employee except those which are:

(a) made in accordance with the provisions of any law or any rule or regulation issued by any governmental agency; or

(b) are expressly authorized in writing by the employee and are for the benefit of the employee; provided that such authorization is kept on file on the employer's premises. Such authorized deductions shall be limited to payments for insurance premiums, pension or health and welfare benefits, contributions to charitable organizations, payments for United States bonds, payments for dues or assessments to a labor organization, and similar payments for the benefit of the employee.

The New York State Department of Labor ("NYSDOL") has recently reiterated that deductions for overpayment of wages, which used to be allowed so long as they did not exceed 10% of the employee's total gross wages, are not permissible — even if the employee has consented to such deductions in writing. Accordingly, the NYSDOL takes the position that offsetting wages for repayment of loans, advances or debts, tuition reimbursement, recovery of employment-related expenses, recovery for spoilage or breakage, purchases made from employers or employer-sponsored stores, cafeterias, and like establishments and cash register shortages are illegal wage deductions. The NYSDOL relies upon two New York Court of Appeals decisions, *Angello v. Labor Ready Inc.*, 7 N.Y.3d 579 (2006) and *Marsh v. Prudential Securities Inc.*, 1 N.Y.3d 146 (2003) to support its position.

In *Labor Ready*, the defendant employed temporary workers who were paid on a daily basis. At the end of each day, employees had the option to be paid by check or by a cash voucher. The cash voucher could be redeemed by inserting it into a cash dispensing machine ("CDM") on defendant's premises. Employees who opted for the cash voucher and used the CDM were charged a service fee, which was automatically deducted from the amount dispensed. The court, in finding for the plaintiff employee, held that the deductions at issue here were not of the type contemplated by the statute and that payments that go directly to an employer violate both the letter of the statute and the protective policy underlying it.

In *Marsh*, the plaintiff executed a written authorization authorizing a percentage of his base wages to be deducted and invested in a deferred stock plan, which contained a forfeiture provision. Plaintiff later claimed that the plan violated Labor Law §193 because, among other reasons, the deferral period and the forfeiture provision violated the "for the benefit of the employee" requirement set forth in §193(1)(b). The court, in finding for the defendant, disagreed and found that the deductions at issue were "for the benefit of the employee" because the employee was afforded favorable tax treatment on this portion of his income. The court further stated that the deductions at issue met the second criteria set forth in §193(1)(b) in that they were "similar" to the types of payments enumerated in the statute.

The NYSDOL's Opinion Letters

Relying on the two cases described above, the NYSDOL takes the position that only two types of payments — monetary payments and supportive payments — may be considered "similar" to the types of payments enumerated in the statute. Monetary payments are investments of money for the later benefit of the employee, such as, deductions for insurance premiums, pension or health and welfare benefits, or payments for United States savings bonds. Supportive payments are amounts that are used by someone other than the employee or employer to support some other purpose of the employee, such as, contributions for charitable organizations or payment for dues to a labor organization.

In recent opinion letters, the NYSDOL concluded that employers may not make deductions from wages to recoup unearned salary or benefits paid to an employee in advance or in error, even if the employee expressly agrees in writing, because they are neither monetary nor supportive. Further, since the payments go directly to the employer, they are exclusively for the benefit of the employer.

What Is Permissible?

It is permissible for an employer seeking to recover an overpayment, payment of a personal loan or the like, to request that the employee repay the amounts owed. It is also permissible to ask employees to advise their employer if they have received an overpayment and to discipline employees who were deceitful in not informing the employer where the overpayment was obvious. In making any request to repay amounts, however, the employer must clearly communicate to the employee that his/her refusal to make the payments will not result in any disciplinary or retaliatory action. In the event the employee refuses to honor the request to repay, the employer's remedy is to file a civil proceeding against the employee to recover the amounts due. Alternatively, employers should be able to recoup these amounts from payments due to employees that are not considered "wages," such as discretionary bonus payments. Prior to taking any such deduction, employers are cautioned to be certain that they have the appropriate policies and authorizations in place.

About the Employment Law Practice Group

Seward & Kissel has extensive experience in the employment field. Our attorneys handle all types of employment disputes in federal and state courts and also represent clients in proceedings before administrative and regulatory agencies, including the EEOC and state divisions of human rights, and in arbitrations before the arbitration tribunals, such as the Financial Industry Regulatory Authority ("FINRA"), the American Arbitration Association ("AAA") and JAMS. We also regularly counsel clients with respect to employment issues. Our primary clients in the employment area are financial institutions and investment fund managers. We advise our clients on all facets of employer-employee relations, including pre-employment inquiries, negotiating of employment and executive compensation agreements, non-competition agreements (and related contractual issues), issues that arise from hiring decisions, the application of discrimination laws, harassment complaints, the scope and enforcement of restrictive covenants, the employee's duty of loyalty, whistleblower claims, equal employment opportunity matters, staff reductions, employment terminations, assembling business teams and compensation matters. We develop employee handbooks, manuals and other employment policies and procedures. Together with our Taxation and Employee Benefits practice, we handle executive compensation matters both for management and executives, including incentive and deferred compensation arrangements, stock options, employee stock ownership plans and benefits issues. Seward & Kissel is a leading adviser with respect to the particular employment issues investment fund managers encounter, including those that are building their businesses and others that are established. We offer seasoned counsel with judgment and perspective in employment matters.