Toward a Workable Contractor Business Model in the Delivery Industry

By Jim Bourbeau

Many courier and delivery companies have faced an uphill battle with the state and federal governments, by using an independent contractor model for driver services. The legal issues can be confounding, frustrating, and ultimately very costly to the business owners of California. I will first attempt to distill the issues down considerably for the purposes of this article and then offer some possible solutions, which I believe will help withstand judicial and governmental scrutiny and better enable a delivery business to utilize contractor drivers.

Without an exhaustive legal analysis, the following recurrent themes dominate California court and administrative decisions regarding the classification of delivery drivers as either independent contractor or employees:

1. Judicial tendency to apply the "economic reality" and "pervasive control" test in driver cases;
2. Judicial tendency to weigh "secondary factors" toward findings of employee status in driver cases; and
3. Judicial tendency use driver agreements as "strong evidence" toward a finding of employee status.

Where there may be an absence of overt control over the manner and means of a delivery driver's work, there exists a question of the "right to control" the manner and means of the delivery work, *and* there exists a questions of the applicability of various "secondary factors" of a worker's status, a court often applies what is called the "economic reality" test and finds what has been called "pervasive control" over the operation as whole. This legal "test" or "factor," first appeared in federal labor law cases, and shows up in prominent California worker classification cases such as *Borello*, *JKH Enterprises*, and *Yellow Cab Cooperative*. If a court cannot find overt use of control over contract workers, it will determine that the workers' freedom or power in the work relationship— i.e. freedom to bargain and negotiate, opportunity for profit or loss, and the ability to work for others – is, as the courts have said "largely illusory," because it is a "simple economic fact -- the [workers] need to eat." This test is coupled with the "pervasive control" test, which is often uttered in the same judicial breath. As applied, pervasive control is the vague notion that, because workers might be reliant in their work for sustenance, there exists an overshadowing or "pervasive control" over their activities, where actual control may not be present. In practice, more is required than a court's finding pervasive control over an operations drivers, however, it is not rare to see bootstrapping of this ambiguous standard with other, what are called, "secondary factors" of worker status to get what is sometimes, I fear, a desired result out of a pretty decent case for legitimate contractor relationships.

Certainly at the tax audit level, the government's analysis will tend toward a more basic assumption that, if it is a delivery business, the drivers are likely to be properly classified as employees. The secondary factors, which are used to determine worker status, tend to favor the government. Typically, in considering factors such as the level of skill involved in the service, the instrumentality and tools supplied, the place of work, whether the work is integral to the business, whether the contractor is in a separately established business, or the length of time the work is the delivery industry, the government and courts have tended to view these preceding

factors to be in favor of finding drivers as being employees and not independent contractors. The judicial tendency to disproportionately weigh the secondary factors in an irrational manner, further adds to the frustration that the courts and the government are thus biased. Nowhere in the judicial decisions on worker status are the secondary factors clearly weighted as to hierarchy. In fact, in the California Code of Regulations, Title 22 section 4304-1, it simply states that a determination will depend upon a "grouping" of these secondary factors "that are significant in relationship to the service being performed."

What does this mean in practice? It grants a wide open playing field for a judge to or the government (in this case the Employment Development Department), to weigh or "group" the factors as they see fit, and occurs frequently in tax hearings. (If, for example, five factors favor a finding of contractor status and five favor a finding of employee status, the judge might simply rely on those factors which favor employee status, and do so without what I think is a sufficient explanation of why one factor should outweigh another. In practice it's like a judicial toolbox to attain a result.)

Finally, if a court or the government finds that a written agreement between the contractor and delivery company is "terminable at will and without cause," that will be used as strong evidence of employment status. I have seen cases live and die on these worker agreements. If the agreements are weak, a company's case can be lost.

As most California delivery businesses are painfully aware, the deck is stacked against use of the contractor business model and the majority of California court decisions and the legislative and judicial trends across the country do not favor the independent contractor model as it is applied to delivery driver services. This is especially true because the courts, and subsequently the state, see driving as a "low-skilled" occupation, and will apply the economic reality/pervasive control test, if other factors are inconclusive. Regardless, there is a way to use independent contractor services that benefit both drivers and owners, while satisfying the government and the courts. It will, however, take concentrated legal and business planning, and will rely on the business owner's acceptance that bona fide contractor relationships come with some acceptable risk on their side.

I recommend first having an attorney familiar to this area of law and the delivery industry draft a solid independent contractor agreement. The language and application of this agreement need to withstand the scrutiny of both the government and the courts. If the agreement is sufficient, it may very well serve to end questions concerning workers' statuses at the government audit level. If the government entity, such as the Employment Development Department, proceeds with an assessment based on driver classification, it will certainly help the company's case at a tax hearing before an administrative law judge. Judicial decisions on contractor status have decided favorably for businesses when the agreements call for termination for material breach, and with penalties for termination without cause. In addition, a "cooling off" period, whereby the agreement may not be immediately terminated, will help steer the relationship away from that of an "at-will" relationship. Make certain that personal service by the contractor is not required to perform the work. Grant a specific right to work for others in the agreement. I would even require the contractors to submit and bargain for bids. Furthermore, a declaration of separate and distinct business of the contractor should be included, along with evidence of bona fide business status.

Remember, this agreement must be utilized in a practical way; it cannot be a mere "boilerplate" agreement or jargon. It may also not be a "subterfuge," as courts have called some agreements. The business must accept that using contractors in place of employees entails some risk on their part. I am convinced, however, that such risk can be acceptable and non-detrimental to the company if well-considered. For example, with respect to penalties for termination, a company can probably live with a penalty such as a specified percentage of the prior week's delivery invoices for early termination. This will show a judge that this relationship is not an "at-will" relationship.

The above suggestions are not offered as legal advice specific to your individual business. They are general suggestions that come from seeing a considerable number of independent contractor agreements over six or more years. It is best to hire an attorney with experience in this area to examine your business requirements and practices, and draft agreements that work for your business and withstand judicial scrutiny.

Second, avoid the obvious indications of control, such as "driver handbooks," training meetings, uniforms that are not required by airport rules, or municipal codes. Once again, seek the advice of an accounting or legal professional who can review your practices and advise you on what you can do to establish a legitimate contractor relationship. In my experience, there are many more ways companies can operate successfully and withstand scrutiny by the government and courts. It does take active planning and acceptance that having contractors brings changes in the nature of the working relationship. The risk is that when using legitimate contractors, you must rely on them providing results without your guidance and oversight. However, this risk is accepted continually by many businesses. With planning, it can be managed.

Third and finally, have an attorney familiar in this area advise you on what can be done to support the abovementioned secondary factors which tend to show a contractor relationship. Require contractors to be, or who are willing to be, in their own separately established business, such as those who have motor carrier permits, advertise their services, carry sufficient insurance, actually provide services to others, etc. There are ways to operate that will legitimize your contractor-based business in the eyes of the courts and the government; but, a business must be willing to create that legitimate relationship.

Some secondary factors, however, are just not going to fall the way showing the contractor relationship when it comes to delivery companies. For instance, the abovementioned factor of driving being integral to the delivery business is nearly unattainable for a delivery company. *Don't despair!* If nearly all the other factors show a solid contractor relationship, the courts can avoid the economic reality and pervasive control test, and can reasonably be expected to see the legitimate nature of your contractor business model.

To sum it up: Build a genuine contractor relationship that works for your business goals, and the courts and government will be more inclined to agree with you.

James Bourbeau is an Associate Attorney at the Law Office of Williams & Associates in Sacramento, California and a former attorney with the Employment Development Department. Jim can be reached at Jim@WilliamsLawAssociates.com.