SUTHERLAND

LEGAL ALERT

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Lessons Learned as Court Denies Motion to Dismiss FLSA Collective Action That Alleges Financial Advisors Misclassified as Independent Contractors

A California federal court recently refused to dismiss a putative class/collective action against Waddell & Reed, Inc., alleging that the financial services firm misclassified its financial advisors as independent contractors rather than employees. In *Taylor v. Waddell & Reed, Inc.*, Civil Action No. 09-cv-2909 (S.D. Cal. Aug. 12, 2010), the court held that the plaintiffs raised sufficient factual allegations of an employment relationship under the Fair Labor Standards Act (FLSA) and California law to survive Waddell & Reed's motion to dismiss.

Background

Plaintiffs originally filed suit in December 2009, alleging multiple violations of the FLSA and California state wage and hour laws. Plaintiffs later amended their class action complaint, alleging that Waddell & Reed misclassified its financial advisors as independent contractors rather than employees.

To determine whether a worker should be classified as an employee or an independent contractor under the FLSA, courts employ the "economic realities" test. Under this test, a court looks to a number of factors, including:

- The degree of the alleged employer's control of the manner in which the work is performed;
- Whether the alleged employee's opportunity for loss or profit depends on his/her managerial skill;
- The alleged employee's investment in any equipment and materials for his/her tasks;
- Whether the alleged employee's services require any special skills;
- The degree of permanence in the working relationship; and
- Whether the service rendered to the alleged employer is an integral part of the business.

The *Waddell & Reed* court noted that none of these factors are dispositive. Rather, courts evaluate the totality of the circumstances in making a determination on the classification of a worker.

Waddell & Reed moved to dismiss the complaint for failure to state a claim upon which relief can be granted because wage and hour laws apply to employees, not independent contractors. Waddell & Reed argued that the facts underlying the plaintiffs' allegations of an employment relationship are nothing more than control requirements arising from state and federal regulations, such as those regulations imposed by the Financial Industry Regulatory Authority, Inc. (FINRA). The company argued that "the indicia of control mandated by state and federal regulations should not be considered in determining whether plaintiffs were employees" and, if the court stripped away these control measures, plaintiffs failed to allege an employment relationship under the applicable wage and hour laws. The court rejected this argument, denying the motion to dismiss the broker-dealer.

While the court agreed that compliance with state and federal regulations "is not indicative of control for purposes of establishing an employer-employee relationship," the classification analysis does not stop there. The court noted that FINRA, unlike other regulators, does not regulate the amount of supervision each member must provide for its representatives to ensure compliance with applicable securities laws.

The court found that the plaintiffs alleged sufficient facts to show that Waddell & Reed "may have gone beyond the general supervision required by FINRA and created an employer-employee relationship." In reaching this decision, the court noted plaintiffs alleged that Waddell & Reed's financial advisors were required to:

- Work a specified number of hours;
- Adhere to a work schedule proposed by the company;
- Explain any activities conducted outside the office;
- Attend meetings or face disciplinary action;
- Have performance reviews; and
- Achieve performance quotas and sales goals.

The court also noted that Waddell & Reed's financial advisors were encouraged to work at the company's offices and use company equipment. Based on these allegations, not even an amicus brief filed by the Financial Services Institute detailing the importance of the independent broker-dealer model, including a reliance on independent financial advisors, moved the court to grant Waddell & Reed's motion to dismiss. Instead, the court determined that plaintiffs had alleged violations of the FLSA and California wage and hour laws for which relief could be granted.

Lessons Learned from *Waddell & Reed*

Companies can take away several lessons from *Waddell & Reed* including:

Worker Classification is Factually Driven.

Waddell & Reed highlighted that worker classification, by nature, involves a fact-intensive examination. The interactions between the hiring party and the hired party provide the foundation for a court to make its classification determination. This examination will need to be performed on a case-by-case basis because each relationship is different. While *Waddell & Reed* provides insight into indicia of employment that a court finds sufficient enough to survive a Rule 12(b)(6) dismissal, courts may vary on the outcome since the classification decision involves a fact-intensive examination.

Uncertain Legal Guidance Leads to Uncertain Results.

The *Waddell & Reed* court highlighted the inherent difficulty in forecasting or predicting worker classification under the "economic realities" test (or any other classification test for that matter). Classification tests typically involve a number of criteria and none of them are dispositive. Courts subjectively analyze the facts of these cases based on an ambiguous "totality of the circumstances" standard. The lack of uniform application of the classification criteria, therefore, frequently results in varying outcomes in class/collective actions.

Don't be Lulled into a False Sense of Security.

Companies should not be lulled into a false sense of security that their contractor workforce is properly classified simply because a worker signed an agreement identifying himself or herself as an independent contractor or even because a court previously determined that a particular class of workers are independent contractors. Determining whether a worker is an employee or independent contractor

involves an analysis that goes outside the four corners of an independent contractor agreement. While a solid agreement is a good first step, a company's policies and procedures play a critical role in determining the proper classification of a worker. Companies should pay particular attention to whether their policies and procedures allow for unnecessary control over independent contractor.

Regulations Do Not Provide Carte Blanche Right to Control Contractors.

While regulated entities may have to comply with certain regulatory control requirements, companies must decide what aspects of control are required and what aspects of control are designed to achieve business efficiencies. Companies should consider eliminating, or at least streamlining, superfluous aspects of control to protect and strengthen their contractor model. Companies then must actually follow their policies and procedures because courts and reviewing agencies examine how policies are implemented, not simply what they say.

What Could Employers Do?

Litigation by workers claiming to be employees rather than independent contractors will continue to increase in the coming years because the independent contractor model is under attack on all fronts. Both state and federal agencies have intensified their focus on worker misclassification through task forces, commissioned studies, congressional hearings, new or proposed legislation including criminal sanctions and, most importantly, increased enforcement efforts. These attacks on the contractor model are spurring workers, unions and plaintiffs' attorneys to continue to bring lawsuits. Companies may want to seek appropriate advice on how to best insulate their contractor model from attack.

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If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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