

## Supreme Judicial Court Decision Heightens Concern for Businesses Using Independent Contractors

On August 21, 2009, the Massachusetts Supreme Judicial Court in *Somers v. Converged Access, Inc.* held that an employee misclassified as an independent contractor is entitled to recover damages under Massachusetts wage and hour laws even if the individual received more money as an independent contractor than he would have received if properly classified as an employee. More significantly, the Court also signaled that persons misclassified as independent contractors may use the Massachusetts wage act to recover other benefits such persons would have received as employees, including vacation pay, holiday pay, employer contributions for employee health, dental and life insurance plans, and employer contributions for employee 401(k) and flexible spending account plans. The decision creates (or at least highlights) a dangerous and uncharted area of legal exposure and likely will lead to a further rise in misclassification claims against businesses using independent contractors.

### The Facts of the Case

Robert Somers twice unsuccessfully applied for full-time employment with Converged Access, Inc. ("CAI"). Somers thereafter agreed to work for

CAI on a temporary basis as an independent contractor testing CAI's software products, and he was paid \$65 per hour, an amount much greater than he would have received as an employee. As an independent contractor, Somers did not receive extra pay when he worked more than 40 hours per week and did not receive benefits enjoyed by CAI employees, including vacation pay, holiday pay, group insurance and 401(k) plan benefits.

Somers performed his work for CAI at its headquarters in Billerica, Massachusetts. CAI provided him with a workspace, lab bench and equipment. CAI told him when to report and assigned and supervised his work, providing him with detailed instruction as to how and when to perform each test. Somers submitted invoices for hours worked.

About two months into his independent contractor relationship CAI notified Somers that his contract would be terminated. Somers then again unsuccessfully applied for full-time employment with CAI. He subsequently filed suit in Superior Court claiming, among other things, that CAI violated the Massachusetts wage laws (M.G.L. c. 149, §§148, 148B

and M.G.L. c. 150) by misclassifying him as an independent contractor and failing to pay him overtime, vacation and holiday pay, and also failing to provide him with other employee benefits.

CAI filed a motion for summary judgment, arguing that even if Somers was misclassified he was paid more for his services as an independent contractor than he would have received if he had been classified as an employee. The Superior Court granted CAI's motion, concluding that Somers had suffered no damages as the result of any misclassification. Somers appealed and the Supreme Judicial Court ("SJC") transferred the appeal from the Appeals Court on the SJC's own initiative.

### The SJC's Analysis

In addressing the merits of the appeal, the SJC reviewed the statutory test (M.G.L. c. 149, §148B) for determining whether an individual performing services for another may



be treated as an independent contractor for purposes of the Massachusetts wage and hour laws (M.G.L. c. 149 and M.G.L. c. 151). Under c. 149, §148B, the party receiving services must establish by a preponderance of the evidence that:

(1) the individual is free from control and direction in connection with the performance of the service, both under his contract for performance of service and in fact; and

(2) the service is performed outside the usual course of the business of the employer; and

(3) the individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.

This test, which was amended in 2004, is exceedingly difficult for most businesses to meet. The SJC stated that when the party receiving services fails to meet this test the individual providing services “is an employee” and receives the protections of M.G.L. c. 149 and M.G.L. c. 151. M.G.L. c. 149, §148 requires employers to “pay weekly or bi-weekly each such employee the wages earned by him.” The SJC noted that although the statute does not define the word “wages” it does provide that wages include “any holiday or vacation payments due to an employee under an oral or written agreement.” The SJC also noted that M.G.L. c. 149, §150 authorizes employees claiming to be aggrieved by the independent contractor law, c. 149, §148B, to bring a civil action for

“injunctive relief and any damages incurred, including treble damages for any loss of wages and other benefits.”

For purposes of the appeal, CAI did not dispute that it failed to meet the c. 149, §148B test, that Somers was misclassified as an independent contractor, and that he did not receive wages and other benefits he would have received had CAI classified him as an employee. However, CAI contended that the dismissal of Somers’ claim was proper because the Superior Court judge correctly concluded that Somers was paid more as an independent contractor (at \$65 per hour) than he would have received as an employee and therefore suffered no damages. The SJC disagreed.

The SJC held that if Somers is determined to be an employee then the \$65 per hour he received as an independent contractor should be considered his hourly wage rate and used for calculating his damages (which are subject to mandatory trebling), including any overtime pay owed. The SJC emphasized that the wage act, including §148B, is a strict liability statute and that, “[g]ood faith or bad, if an employer misclassified an employee as an independent contractor the employer must suffer the consequences.” According to the SJC, “[w]ere employers who violated the statute permitted a ‘safe harbor’ that allowed them to demonstrate that they would have paid the employee less had they known he or she was not an independent contractor, there would be no financial incentive to ensure employer compliance and employees would be left with no meaningful protection from misclas-

sification.” In making this statement the Court did not recognize that the wage act authorizes the Attorney General to impose substantial civil and criminal penalties for misclassification, and further permits the Attorney General to debar violators from public works contracts. In addition, §148B(d) creates personal liability for individuals, including corporate officers and those with management authority over the affected workers.

The SJC rejected CAI’s argument that its decision would cause misclassified employees to “enjoy a ‘windfall’ at the employer’s expense, especially considering the [mandatory] remedy of treble damages.” The SJC then stated that “[t]he ‘windfall’ the Legislature appeared most concerned with is the ‘windfall’ that employers enjoy from the misclassification of employees as independent contractors: the avoidance of holiday, vacation, and overtime pay; Social Security and Medicare contributions; unemployment insurance contributions; workers’ compensation premiums; and income tax withholding obligations.” This statement seems questionable because the independent contractor test contained in c. 149, §148B is used only for purposes of enforcing the wage and hour laws contained in M.G.L. c. 149 and M.G.L. c. 151, which the Legislature enacted to establish and protect employee rights, not to prevent any employer windfall. Moreover, the independent contractor standard for purposes of Social Security and Medicare contributions is a matter of federal law, not Massachusetts law, and the independent contractor tests/standards used for purposes of unemployment insurance

contributions, workers' compensation premiums, and state income tax withholding obligations are contained elsewhere in the Massachusetts General Laws (c. 151A, c. 152, and c. 62B) and are less stringent than the c. 149, §148B test.

The SJC further stated that “[m]isclassification not only hurts the individual employee; it imposes significant financial burdens on the federal government and the Commonwealth in lost tax and insurance revenues.” However, this statement again ignores the fact that the test contained in c. 149, §148B is used only for purposes of enforcing the wage and hour laws contained in M.G.L. c. 149 and M.G.L. c. 151, and does not apply to tax or insurance payment obligations.

The reality is that many independent contractors prefer, or even insist, that they be engaged as independent contractors, not employees. Indeed, thousands of individuals have established their own independent contractor businesses (many incorporating or creating limited liability companies) and dutifully pay self-employment taxes and insurance premiums. As a result of c. 149, §148B, particularly after its amendment in 2004, many companies that use independent contractors and want to continue doing business in Massachusetts face the choice of either complying with c. 149, §148B and losing the use of skilled independent contractors or not complying and facing significant potential liability. In *Somers*, however, the SJC's analysis seems to assume that all businesses misclassifying independent contractors are taking advantage of the contractors and that the contractors themselves

do not pay their taxes.

The SJC rejected CAI's contention that the substantial compensation paid to Somers could be viewed as “a valid set-off” against his wages. M.G.L. c. 149, §150 does provide “a valid set-off” as defense to a wage act claim, but the SJC stated that it understood the term “to refer to circumstances where there exists a clear and established debt owed to the employer by the employee.” In this case, the SJC concluded that “there was no evidence of any debt that the plaintiff owed to CAI, and no basis to invoke the ‘valid set-off’ defense.”

The SJC vacated summary judgment and in remanding the case to the Superior Court the SJC stated that the issue at trial “will be whether the plaintiff was properly classified as an independent contractor under G.L. c. 149, §148B.” However, as the SJC likely recognized, given the facts of the case and the exceedingly difficult test contained in c. 149, §148B, it will be **impossible** for CAI to establish that Somers was properly classified as an independent contractor; thus, the only issue left for trial will be damages.

### **The SJC's View Concerning Wage Act Damages**

The SJC stated that “if” CAI is unsuccessful in meeting the c. 149, §148B test Somers will be entitled to all “damages incurred,” including “treble damages for ‘any lost wages and other benefits.’” The SJC stated that “damages incurred” will include “any wages and benefits [Somers] proves he was denied because of his misclassification as an independent

contractor, including the holiday pay, vacation pay, and other benefits that he would have been entitled to as a CAI employee.” It is this last holding in *Somers* that may be most troubling for businesses using independent contractors because previously most businesses did not include holiday pay, vacation pay, and “other benefits” in their evaluation of potential damages for misclassification **under the wage act**. Earlier in its opinion the SJC indicated that such “other benefits” include contributions for employee health insurance plans, dental insurance plans, and life insurance plans, and contributions to employee 401(k) plans and flexible spending account plans.

The expansive view of potential damages under the wage act expressed in *Somers* may be narrowed as lower courts try to reconcile the SJC's broad statements with the statutory language and conflicting legal principles. For example, c. 149, §148 provides that wages include only holiday or vacation payment “due an employee under an oral or written agreement.” Although the SJC in *Somers* recited the statute's language, the Court's analysis did not address the words “under an oral or written agreement.”

Unlike the payment of minimum wage and the payment of overtime pay (when a non-exempt employee works over forty hours in a work week), there is no statutory right to any holiday pay or vacation pay absent an agreement between the employee and employer. Employers are free to provide paid holidays and vacation days to employees or not, and generally are free to award differing amounts of such paid time off to

individual employees at the employer's discretion, absent any contractual restrictions (and, of course, without engaging in unlawful discrimination). Regardless of whether someone is being engaged as an independent contractor or as an employee, an employer may lawfully tell an individual that he will not be entitled to receive holiday pay or vacation pay. Thus, it seems inconsistent for the SJC to hold that an individual who is told and understands (when engaged as an independent contractor) that he is not entitled to receive any holiday pay or vacation pay, if misclassified, automatically becomes entitled to the holiday pay and vacation pay he "would" have received if hired as an employee. Nonetheless, the *Somers* decision suggests that the misclassified individual should be matched up with similarly situated employees (if any exist) and given whatever holiday pay and vacation pay is owed to such employees (presumably due "under an oral or written agreement," as c. 149, §148 provides).

## ERISA Preemption

The SJC's statement that the Massachusetts wage act can be used to recover employer contributions for employee health insurance plans, dental insurance plans, and life insurance plans, and contributions to employee 401(k) plans and flexible spending account plans (multiplied by three) is more alarming but likely less consequential for businesses. Interpreting the wage act to authorize

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the recovery of such "benefits" creates enormous potential legal exposure for businesses, and also creates some real practical difficulties in determining damages. Take, for example, employer 401(k) matching contributions where, under the SJC's reasoning, a court might be required to determine what a misclassified individual would have contributed to his 401(k) plan account if he had been hired as an employee. However, the *Somers* decision does not consider that group health and retirement plans are regulated by the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.* ("ERISA"), and that ERISA generally preempts all state laws relating to such plans. Thus, Massachusetts wage act claims to recover contributions to group health insurance and 401(k) plans would likely be preempted by federal law. Consequently, regardless of the SJC's seemingly expansive interpretation, ERISA preemption should limit the *Somers* decision's impact in this area.

## Conclusion

Under the SJC's decision in *Somers*, businesses using independent contractors in Massachusetts will need to understand that the rate of compensation paid under independent contractor arrangements will be used to calculate a contractor's wage rate if the contractor is later determined to be an employee under the c. 149, §148B test. Further, businesses should consider holiday pay and vacation pay in their evaluation of potential liability. Businesses can hope that the SJC does not mean what it appears to be saying in *Somers* concerning the scope of potential

damages recoverable under the Massachusetts wage act, or that ERISA preemption, future court decisions and/or legislative action will limit the decision's potential impact. For now, however, businesses should be concerned. At a minimum, *Somers* will encourage new and more dangerous misclassification lawsuits, and will cause some independent contractor dependent businesses to question whether to continue doing business in Massachusetts.

An article analyzing the Massachusetts Independent Contractor Law can be found at [http://www.mbbp.com/resources/employment/independent\\_contractor.html](http://www.mbbp.com/resources/employment/independent_contractor.html).

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