Note

Balancing the ERISA Seesaw: A Targeted Approach to Remedying the Problem of Worker Misclassification in the Employee Benefits Context

*Tracy Snow**

Introduction

Employees cost a lot. Consider the following scenario: Two companies, Letter of the Law Ltd. ("Letter of the Law"), and Cutting Corners Co. ("Cutting Corners"), want to increase the size of their workforce to satisfy escalating production demands. To add extra employees, each company must absorb the costs of paying state and federal employment taxes and providing pension and welfare benefits to these workers. Neither company can meet these expenses and remain in business. Instead of throwing in the towel, both employers hire independent contractors, a decision that allows them to avoid the costs of payroll taxes and employee benefits.

Like Letter of the Law and Cutting Corners, many companies are increasingly using independent contractors to reduce costs in an environment characterized by unexpected fluctuations in the market and

---

* J.D., May 2011, The George Washington University Law School; B.A., 2005, The College of William and Mary. I owe countless thanks to Kimberly Sikora Panza, Allison Owen, and Michael Viglione for their invaluable support and insight throughout this process. I also thank Alex Hastings, Chris Dawson, Johanna Hariharan, and Richard Crudo for their careful editing.

June 2011 Vol. 79 No. 4

intense global competition.[1] Independent contractors, also called "freelancers," are self-employed individuals who render services directly to companies outside the scope of the traditional employment relationship.[2] Courts and agencies use various common law tests to distinguish independent contractors from employees. The widely used control test, for example, gauges the amount of control exerted by the hiring party over "the manner and means by which the [work] product is accomplished."[3]

To abide by the control test, Letter of the Law and Cutting Corners must relinquish a significant amount of control over their workers before classifying them as independent contractors. Suppose the following occurs: Letter of the Law allows its workers to set their hours and work from home. Cutting Corners, however, labels its workers as independent contractors, yet intentionally retains the same level of control it exercises over its common law employees.

Now suppose that the Internal Revenue Service ("IRS") audits the companies and, using its own version of the control test, concludes that the companies misclassified their workers.[4] Misclassification occurs when a worker labeled as an independent contractor actually meets the control test definition of an employee.[5] The IRS could have reached its conclusion for any number of reasons; perhaps it determined that Letter of the Law retained the right to control its workers (even though it did not exercise such control) and thus misclassified them.[6]

---

1 *See* Orly Lobel, *The Slipperiness of Stability: Contracting for Flexible and Triangular Employment Relationships in the New Economy*, 10 TEX. WESLEYAN L. REV. 109, 112, 115 (2003); Katherine V.W. Stone, *Legal Protections for Atypical Employees: Employment Law for Workers Without Workplaces and Employees Without Employers*, 27 BERKELEY J. EMP. & LAB. L. 251, 253–54 (2006).

2 JAYNE E. ZANGLEIN & SUSAN J. STABILE, ERISA LITIGATION 1404 (3d ed. 2008).

3 Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 323 (1992) (quoting Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 751 (1989)). Besides the control test, courts have also used the economic reality test, which regards employees as "those who as a matter of economic reality are dependent upon the business to which they render service." Bartels v. Birmingham, 332 U.S. 126, 130 (1947). For a comprehensive history of both tests, see Richard R. Carlson, *Why the Law Still Can't Tell an Employee When It Sees One and How It Ought to Stop Trying*, 22 BERKELEY J. EMP. & LAB. L. 295, 304–34 (2001).

4 *See* Rev. Rul. 87-41, 1987-1 C.B. 296, 296–99 (outlining twenty-factor control test used by IRS to classify employees); *see also* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, INDEPENDENT CONTRACTOR OR EMPLOYEE?: TRAINING MATERIALS 2-3 to -4 (1996) [hereinafter IRS, TRAINING MATERIALS].

5 *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-717, EMPLOYEE MISCLASSIFICATION: IMPROVED COORDINATION, OUTREACH, AND TARGETING COULD BETTER ENSURE DETECTION AND PREVENTION 3–4 (2009).

6 *See* Gierek v. Comm'r, 66 T.C.M. (CCH) 1866, 1868–69 (1993) (stating that a worker

Although both Letter of the Law and Cutting Corners misclassified their workers, their behavior vastly differed: the former mistakenly interpreted the common law standard, while the latter knowingly disregarded the test's requirements. A host of federal and state laws recognize the distinction between the behavior of these companies. Under federal law, for example, the IRS may assess tax liabilities stemming from misclassification.[7] A federal safe harbor provision, however, relieves employers like Letter of the Law, which, among other things, had a good faith basis for its mistaken classification.[8] Recently enacted state laws, such as Maryland's Workplace Fraud Act,[9] impose harsher penalties on employers who knowingly misclassified their workers than on employers who misclassified without the requisite intent.[10] Pursuant to these standards, Letter of the Law would potentially avoid liability, while Cutting Corners would face severe penalties.

Under the Employment Retirement Income Security Act of 1974 ("ERISA"),[11] the federal law that regulates employer-sponsored wel-

may be considered an employee if the business had a right to control the worker, even if it did not actually control the worker).

7 An employer who misclassified a worker could be required to pay a portion of the taxes it should have withheld from the worker's paycheck, I.R.C. § 3509(a) (2006), and additional penalties for the failure to file a tax return, *id.* § 6651(a)(1)–(3).

8 The safe harbor provision, section 530 of the Revenue Act of 1978, allows employers to escape federal employment tax liability if three requirements are met: reporting consistency, substantive consistency, and a reasonable basis for the classification. *See* Revenue Act of 1978, Pub. L. No. 95-600, § 530, 92 Stat. 2763, 2885–86 (amended 1979, 1980, 1982, 1986, 1996, 2006, 2008). Section 530 is technically not part of the Internal Revenue Code, although its text is included in the notes accompanying I.R.C. § 3401(a) (West 2006). IRS, TRAINING MATERIALS, *supra* note 4, at 1–3.

9 Workplace Fraud Act, MD. CODE ANN., LAB. & EMPL. §§ 3-901 to -920 (LexisNexis Supp. 2010).

10 *Compare id.* § 3-909 (requiring employers who knowingly misclassified their workers to pay an automatic civil penalty and restitution to employees "up to three times the amount" to which they are entitled), *and id.* § 3-911 (providing a private right of action where employees can obtain triple damages from employers who knowingly misclassified them), *with id.* § 3-908 (allowing employers who misclassified their workers, but did not do so knowingly, to escape civil penalties by timely complying with state labor laws). Kansas and New Mexico have also enacted misclassification statutes that differentiate employers based on their behavior. *See* KAN. STAT. ANN. § 44-766(a) (Supp. 2009) ("No person shall knowingly and intentionally misclassify an employee as an independent contractor . . . ."); N.M. STAT. ANN. § 60-13-3.1(C) (Supp. 2010) (specifying that a person who "intentionally and willfully" misclassifies an employee as an independent contractor is guilty of a misdemeanor).

11 Employee Retirement Income Security Act (ERISA) of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001–1461 (2006) and in scattered sections of the Internal Revenue Code). Most practitioners refer to ERISA's original section numbers. Accordingly, this Note will cite to the original section number, followed by a parallel citation to the United States Code section number.

fare and pension plans, the outcome would not be so clear. ERISA provides the misclassified worker a statutory right to recover benefits due under an established employee benefit plan.[12] Although federal courts have adopted divergent standards to assess benefits claims made by misclassified workers, the standards share a common thread: unlike the IRS and Maryland state law, they fail to differentiate employers who inadvertently misclassify from those who knowingly misclassify.

This Note discusses the inability of federal courts to adopt a coherent standard that distinguishes between good and bad faith employers in the ERISA context. The courts' failure to make this critical distinction contravenes the underlying policy goals of ERISA. Congress enacted ERISA in 1974 to curb rampant abuse in pension-plan administration.[13] Although primarily protective, ERISA affords employers ample discretion in the design of their benefit plans.[14] Thus, ERISA strikes a delicate balance between employee protection and employer freedom, a balance reflected in its carefully constructed remedial scheme.[15]

The standards adopted by federal courts to interpret claims made by misclassified workers upset the balance achieved by ERISA—while some courts tip toward employee protection, others favor employer freedom.[16] To harmonize these competing goals, this Note proposes an amendment to ERISA that narrowly targets abusive employer behavior. Under the proposed amendment, a misclassified worker who would otherwise be covered under an employee benefit plan could receive benefits by proving that her employer knowingly misclassified her.

Part I of this Note explores the role of the independent contractor in the labor market as well as the problem of misclassification. Part II discusses the purposes and provisions of ERISA. Part III explores the conflicting standards courts follow to assess benefits claims

---

12 *Id.* § 502(a)(1), 29 U.S.C. § 1132(a)(1).

13 STAFF OF S. SPECIAL COMM. ON AGING, 98TH CONG., EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: THE FIRST DECADE 6 (Comm. Print 1984) (article of Michael S. Gordon).

14 *See, e.g.*, Johnson v. Ga.-Pac. Corp., 19 F.3d 1184, 1188 (7th Cir. 1994).

15 *See, e.g.*, Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 54 (1987).

16 *Compare* Vizcaino v. Microsoft Corp., 120 F.3d 1006, 1010–13 (9th Cir. 1997) (en banc) (invalidating independent contractor agreements even though the workers manifested their intent to be classified as independent contractors), *with* Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405, 1409–11 (10th Cir. 1998) (upholding independent contractor agreements notwithstanding the workers' potential status as common law employees).

made by misclassified employees, positing that these approaches upset the balance between employee protection and employer freedom achieved by ERISA. Part IV describes this Note's proposed ERISA amendment, which aims to harmonize these fundamental policy goals.

I. Background of the Independent Contractor

A. *The Role of the Independent Contractor*

By hiring independent contractors, Letter of the Law and Cutting Corners followed the growing trend of companies that supplement their workforce with freelancers falling outside the traditional employer-employee relationship. In 2005, about 10.3 million workers, or 7.4% of the workforce, were classified as independent contractors.[17] The rise of the independent contractor tracks the globalization of the American economy, a transformation that has induced employers to use flexible staffing arrangements to remain competitive.[18] These alternative workers, who lack the statutory protections afforded traditional employees,[19] can be easily released and rehired in response to shifting market conditions.[20] Additionally, employers can use temporary workers to alter their business model frequently or capitalize on rapidly evolving technological advances.[21] On the whole, flexible staffing arrangements provide a means to reduce administrative costs and increase overall efficiency.[22]

Independent contractors also provide key financial benefits to employers. Many federal labor laws specifically exclude independent contractors from their scope. For example, independent contractors fall outside the protective purview of the Fair Labor Standards Act,[23] which mandates minimum wage and overtime pay requirements,[24] and the National Labor Relations Act,[25] which guarantees employees the

17 News Release, Bureau of Labor Statistics, U.S. Dep't of Labor, Contingent and Alternative Employment Arrangements, February 2005, at 1 (July 27, 2005), *available at* http://www.bls.gov/news.release/pdf/conemp.pdf. Independent contractors comprise the largest group of alternative workers. *Id.*

18 Lobel, *supra* note 1, at 112, 115; Stone, *supra* note 1, at 253–54.

19 *See infra* text accompanying notes 24–27.

20 Mark Berger, *The Contingent Employee Benefits Problem*, 32 Ind. L. Rev. 301, 310 (1999); Lobel, *supra* note 1, at 115.

21 *See* Lobel, *supra* note 1, at 112, 115; Jennifer Middleton, *Contingent Workers in a Changing Economy: Endure, Adapt, or Organize?*, 22 N.Y.U. Rev. L. & Soc. Change 557, 559 (1996).

22 Zanglein & Stabile, *supra* note 2, at 1390.

23 *See* Fair Labor Standards Act, 29 U.S.C. §§ 201–219 (2006).

24 U.S. Gov't Accountability Office, *supra* note 5, at 5.

25 National Labor Relations Act, 29 U.S.C. §§ 151–169 (2006).

right to bargain collectively.[26] Moreover, hiring independent contractors allows employers to avoid paying Social Security taxes, Medicare taxes, and federal unemployment taxes.[27] Independent contractors are also precluded from receiving welfare and pension benefits from employer-provided plans, which significantly reduces employer expenses.[28]

Despite the loss of statutory protections and fringe benefits, many independent contractors relish the advantages afforded by their status, including increased autonomy, flexible hours, and the ability to work for others.[29] Additionally, some freelancers receive higher pay to offset their loss of benefits.[30] Tax law also provides incentives to independent contractors: compared to employees, they can more easily deduct work-related expenses and make tax-deductible contributions to self-established pension plans.[31] Because freelancers can make contributions up to the statutory maximum, while employees are constrained by the limits of their employer-provided plans, freelancers may be able to develop more profitable pension plans than common law employees.[32]

The relationship between the freelancer and the employer, therefore, may constitute a symbiotic arrangement. This relationship is often consummated by an independent contractor agreement

26 U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 5, at 6.

27 INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, PUBLICATION 15-A, EMPLOYER'S SUPPLEMENTAL TAX GUIDE 6 (2010) [hereinafter IRS, PUBLICATION 15-A]. The employer also escapes state payroll taxes. Catherine K. Ruckelshaus, *Labor's Wage War*, 35 FORDHAM URB. L.J. 373, 381 (2008). For a breakdown of tax benefits, see U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 5, at 5 tbl.1.

28 Benefit plans can lose their tax-favored status if they cover independent contractors. ZANGLEIN & STABILE, *supra* note 2, at 1399.

29 Patricia Ball, Comment, *The New Traditional Employment Relationship: An Examination of Proposed Legal and Structural Reforms for Contingent Workers from the Perspectives of Involuntary Impermanent Workers and Those Who Employ Them*, 43 SANTA CLARA L. REV. 901, 908–09 (2003).

30 *See, e.g.*, Vizcaino v. Microsoft Corp., 120 F.3d 1006, 1019 (9th Cir. 1997) (en banc) (O'Scannlain, J., dissenting); Kiper v. Novartis Crop Prot., Inc., 209 F. Supp. 2d 628, 637 (M.D. La. 2002), *aff'd*, 67 F. App'x 252 (5th Cir. 2003).

31 STAFF OF THE JOINT COMM. ON TAXATION, 100TH CONG., JCX-26-07, PRESENT LAW AND BACKGROUND RELATING TO WORKER CLASSIFICATION FOR FEDERAL TAX PURPOSES 2 (2007).

32 *See* Richard J. Kovach, *Taxes, Loopholes and Morals Revisited: A 1963 Perspective on the Tax Gap*, 30 WHITTIER L. REV. 247, 266–67 (2008). For example, independent contractors can establish defined contribution plans, which permit tax-free annual contributions up to $49,000. I.R.C. § 415(c)(1)(A) (2006); *COLA Increases for Dollar Limitations on Benefits and Contributions*, IRS.GOV, http://www.irs.gov/retirement/article/0,,id=96461,00.html (last visited Mar. 23, 2011). In contrast, many employer-provided individual retirement accounts have an annual contribution cap of $7,000. Kovach, *supra*, at 266–67; *see also* I.R.C. § 219(b)(3)(A).

("ICA"), a contract that manifests the intent of both parties to designate the worker as an independent contractor.[33] ICAs, however, are not the exclusive means of classifying workers as independent contractors. An employer may simply give the worker an IRS Form 1099 instead of a Form W-2,[34] or route the worker's paycheck through the accounts payable department rather than payroll.[35] The employer makes the initial classification and need not seek preapproval from the IRS or any other federal agency.[36]

B. Misclassification

Given the ease of classifying workers and the benefits provided by flexible staffing arrangements, many employers feel compelled to fit workers into the independent contractor mold whenever possible. Misclassification, whether inadvertent or intentional, occurs when this mold does not fit. Often, a federal or state agency auditing the employer determines that a worker initially classified as an independent contractor actually meets the definition of an employee under the common law control test.[37]

Misclassification is a rapidly growing trend; according to the Department of Labor, up to thirty percent of companies misclassify their workers.[38] The misclassified worker suffers as a result, losing the statutory protections and plan benefits provided to employees.[39] Misclassification also harms society, causing substantial federal and state tax revenue loss.[40]

---

33 Most ICAs are boilerplate forms, containing statements such as: "It is . . . expressly understood that, as an independent contractor, [t]he Agent will not receive, and has no claim to, any benefits . . . currently paid by [the company] to its employees." Smith v. Torchmark Corp., 82 F. Supp. 2d 1006, 1009 (W.D. Mo. 1999).

34 *See* Ruckelshaus, *supra* note 27, at 378. A Form W-2 is used to report compensation paid to employees, while a Form 1099 is used to report payments made to independent contractors. *Form 1099-MISC & Independent Contractors*, IRS.GOV, http://www.irs.gov/faqs/faq/0,,id=199636,00.html (last visited Mar. 23, 2011).

35 *See* Scruggs v. ExxonMobil Pension Plan, 585 F.3d 1356, 1358 (10th Cir. 2009); Gustafson v. Bell Atl. Corp., 171 F. Supp. 2d 311, 321 (S.D.N.Y. 2001).

36 In Minnesota, individuals must have their independent contractor status certified by the state before starting work. MINN. STAT. § 181.723 subdiv. 4 (2006).

37 *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 5, at 7 tbl.2. Alternatively, an employer or worker may file a Form SS-8 to request the IRS to determine a worker's status for federal income tax purposes. IRS, PUBLICATION 15-A, *supra* note 27, at 7.

38 Steven Greenhouse, *A Crackdown on "Contractors" as a Tax Dodge*, N.Y. TIMES, Feb. 18, 2010, at A1.

39 *See supra* text accompanying notes 24–29.

40 One of the most recent federal studies, conducted in 1996, predicted the annual loss of $3.3 billion in federal tax revenue. Ruckelshaus, *supra* note 27, at 382. A New York task force estimated that misclassification cost the state's taxpayers $489 million in 2005. Christopher Bus-

To combat the problem of misclassification, the IRS initiated a crackdown in 2010, targeting employers who intentionally misclassify their employees to circumvent federal tax law.[41] Additionally, Senator John Kerry spearheaded the proposed Taxpayer Responsibility Accountability and Consistency Act of 2009,[42] which aimed to address the problem in the federal tax context.[43] Many states have also entered the fray, recently enacting laws to abate the rising tide of misclassification.[44]

These state laws, however, cannot remedy abuses in the private pension system. ERISA exclusively regulates employer-provided welfare and pension plans, providing the sole remedy for misclassified workers who have been wrongly denied benefits.[45] The next Part of this Note details the broad scope of this complex statute, which federalizes the field of employee benefits law.

II. Background of ERISA

ERISA regulates the administration of private, employer-provided benefit plans. Benefits provided under a statutorily defined pension or welfare "plan, fund, or program" fall under ERISA's purview.[46] Pension plans supply retirement earnings to employees through direct employer contributions[47] or income deferral.[48] Welfare plans run the gamut, providing, inter alia, health insurance, unemployment insurance, disability or death benefits, vacation benefits, and scholarship funds.[49] If an employer-provided benefits program quali-

caglia, *Crafting a Legislative Solution to the Economic Harm of Employee Misclassification*, 9 U.C. Davis Bus. L.J. 111, 118–19 (2008).

41 Greenhouse, *supra* note 38.

42 Taxpayer Responsibility, Accountability, and Consistency Act of 2009, S. 2882, 111th Cong. (2009).

43 *Id.*

44 *See supra* notes 9–10 and accompanying text. Besides Maryland, Kansas, and New Mexico, other states that have enacted statutes include Delaware, *see* Del. Code Ann. tit. 19, §§ 3501–3514 (2010); *see* Illinois, 820 Ill. Comp. Stat. 185/1-999 (2009); *see* Massachusetts, Mass. Gen. Laws Ann. ch. 149, § 148B (West 2008); *see* Minnesota, Minn. Stat. § 181.722–.723 (Supp. 2010); and New Jersey, *see* N.J. Stat. Ann. § 34:20-1 to -11 (West 2010). For an overview of these laws, see Buscaglia, *supra* note 40, at 122–26.

45 *See infra* notes 63–68, 169, and accompanying text.

46 Employee Retirement Income Security Act (ERISA) of 1974 § 3(1), 29 U.S.C. § 1002(1) (2006); *id* § 3(2)(A), 29 U.S.C. § 1002(2)(A); *see also* Donovan v. Dillingham, 688 F.2d 1367, 1372 (11th Cir. 1982) ("At a minimum, . . . a 'plan, fund, or program' under ERISA implies the existence of intended benefits, intended beneficiaries, a source of financing, and a procedure to apply for and collect benefits.").

47 ERISA § 3(2)(A)(i), 29 U.S.C. § 1002(2)(A)(i).

48 *Id.* § 3(2)(A)(ii), 29 U.S.C. § 1002(2)(A)(ii).

49 *Id.* § 3(1), 29 U.S.C. § 1002(1).

fies as an ERISA plan, the employer is subject to a host of provisions designed to protect employees. Interestingly, although ERISA is a paternalistic statute, it also leaves much discretion to the employer. This dichotomy can be better understood through an examination of ERISA's purpose and provisions.

A. *ERISA's Purpose and Provisions*

Congress enacted ERISA to remedy widespread abuse in the pension-plan system, which regularly deprived employees of their retirement income.[50] An investigation conducted by the Senate Committee on Labor and Public Welfare in the early 1950s unveiled a plethora of abusive practices, including corrupt administration, looting of benefit funds, kickbacks, embezzlements, and excessively high administrative costs.[51] Mismanagement of pension funds left plans severely underfunded;[52] in some high-profile instances, plan defaults stripped thousands of employees of their expected retirement income.[53]

Passed in 1974 after a prolonged congressional battle, ERISA established multiple safeguards to protect employees from the loss of plan benefits.[54] For example, ERISA imposes fiduciary duties on employers and other third parties who exercise discretionary control over plan management or the disposition of plan assets.[55] ERISA also mandates minimum disclosure standards,[56] minimum participation requirements,[57] and vesting provisions.[58] These rules, which represent a

---

50 STAFF OF S. SPECIAL COMM. ON AGING, 98TH CONG., *supra* note 13, at 6. For a case-by-case account of workers whose pension plans were terminated, many after thirty or more years of service, see 120 CONG. REC. 29,934–35 (1974).

51 STAFF OF S. SPECIAL COMM. ON AGING, 98TH CONG., *supra* note 13, at 6; *see also* Philip D. Hixon, Note, *Contingent Workers and ERISA: Should the Law Protect Workers with No Reasonable Pension Expectations?*, 25 OKLA. CITY U. L. REV. 667, 673–74 (2000).

52 STAFF OF S. SPECIAL COMM. ON AGING, 98TH CONG., *supra* note 13, at 16–17.

53 *See* 120 CONG. REC. 29,934 (statement of Sen. Javits) (discussing the Studebaker incident, where approximately 7000 employees of the Studebaker automobile plant in South Bend, Indiana, lost some or all of their benefits after the plant closed). The Studebaker incident, in part, galvanized the movement to pass ERISA. *See* STAFF OF S. SPECIAL COMM. ON AGING, 98TH CONG., *supra* note 13, at 8.

54 *See* Hixon, *supra* note 51, at 668.

55 Employee Retirement Income Security Act (ERISA) of 1974 § 3(21)(A), 29 U.S.C. § 1002(21)(A) (2006). The fiduciary duty provisions can be found in ERISA §§ 402–409, 29 U.S.C. §§ 1102–1109.

56 *Id.* §§ 101–110, 29 U.S.C. §§ 1021–1030.

57 If an employer establishes eligibility rules for pension-plan participation, it cannot require that employees complete a period of service that extends beyond the date on which the employee turns twenty-one years old, or the date on which the employee completes one year of

slice of ERISA's protective measures, help accomplish the policy behind the statute: ensuring that participants receive expected plan income.[59]

Employee protection, however, is merely one side of the story. ERISA only applies if an employer establishes a statutorily-defined plan; "nothing in ERISA requires employers to establish employee benefits plans" in the first instance.[60] Although ERISA does not mandate plan creation, Congress intended the statute "to encourage the maintenance and growth of single-employer defined benefit pension plans."[61] ERISA incentivizes benefit plan formation by minimizing the costs imposed on employers who establish plans.[62] ERISA reduces costs in two ways: it federalizes benefits law to create a uniform system of plan administration, and preserves the employer's discretion over key aspects of the benefit formation process.

ERISA federalizes employee benefits law through its sweeping preemption clause, which provides that the statute's provisions "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."[63] This clause has staggering regulatory implications for the employment law field, reaching so far as to preempt state common law tort and contract actions asserting improper denial of health care benefits.[64] According to the Supreme Court, this provision "was intended to 'ensure that plans and plan sponsors would be subject to a uniform body of benefits law' so as to 'minimize the administrative and financial burden of complying with conflicting directives among States or between States and the Federal Government.'"[65] The federalization of benefits law, therefore, minimizes costs for employers, which incentivizes the creation of employer-provided plans.[66]

---

service, whichever comes later. *Id.* § 202(a)(1)(A), 29 U.S.C. § 1052(a)(1)(A) (cross-referenced in I.R.C. § 410(a)(1)(A) (2006)).

58 ERISA's vesting rules prevent employers from revoking pension benefits once the employee has completed a specified period of service. *See id.* § 203, 29 U.S.C. § 1053.

59 29 U.S.C. § 1001b(c)(3) (Declaration of policy).

60 Lockheed Corp. v. Spink, 517 U.S. 882, 887 (1996).

61 29 U.S.C. § 1001b(c)(2).

62 *See* 120 CONG. REC. 29,944 (1974) (statement of Sen. Long) ("The new requirements have the virtue of providing adequate protection for employees at only moderate additional financing costs for most plans.").

63 ERISA § 514(a), 29 U.S.C § 1144(a).

64 *See* Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 41 (1987).

65 Rush Prudential HMO, Inc. v. Moran, 536 U.S. 355, 392 (2002) (quoting Ingersoll-Rand Co. v. McClendon, 498 U.S. 133, 142 (1990)).

66 *See* FMC Corp. v. Holliday, 498 U.S. 52, 60 (1990) ("To require plan providers to design their programs in an environment of differing state regulations would complicate the administra-

By operation of ERISA's preemption clause, federal law trumps state law regarding most aspects of employee benefit plans,[67] even where federal law is silent.[68] Interestingly, ERISA fails to regulate many aspects of the plan formation process, leaving key decisions to the employer's discretion. When establishing an ERISA plan, an employer has virtually carte blanche authority to decide who receives benefits and to limit the content of those benefits.[69] This freedom can be explained by the "two hat theory," which posits that an employer wears its "employer hat" rather than its "fiduciary hat" when designing the scope of plan coverage.[70] Accordingly, the employer is subject to ERISA no more than when it "decide[s] what wages to offer or whether to . . . lay . . . workers off."[71] Affording employers discretion encourages plan formation; employers will be more likely to offer ERISA plans to their workforce if they can control the level—and thus the cost—of benefits being offered.[72]

Employer freedom over plan design, however, must be tempered by ERISA's original goal—ensuring that employees receive expected pension benefits. According to Senator Jacob K. Javits, one of the law's sponsors, "[ERISA] represents an overall effort to strike a balance between the clearly-demonstrated needs of workers for greater protection and the desirability of avoiding . . . a federally-dictated structure that would discourage voluntary initiatives for further ex-

---

tion of nationwide plans, producing inefficiencies that employers might offset with decreased benefits.").

67 The insurance savings clause exempts any state law that "regulates insurance, banking, or securities" from preemption. ERISA § 514(b)(2)(A), 29 U.S.C. § 1144(b)(2)(A).

68 Daniel M. Fox & Daniel C. Shaffer, *Semi-Preemption in ERISA: Legislative Process and Health Policy*, 7 AM. J. TAX POL'Y 47, 48 (1988).

69 *See, e.g.*, Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 511 (1981); Bronk v. Mountain States Tel. & Tel., Inc., 140 F.3d 1335, 1338 (10th Cir. 1998); Johnson v. Ga.-Pac. Corp., 19 F.3d 1184, 1188 (7th Cir. 1994). This discretion is subject to some limitations in the pension context, such as ERISA's minimum participation requirements. *See supra* note 57. The recently enacted Patient Protection and Affordable Care Act may prescribe minimum content standards for employer-provided health plans, but the law does not limit an employer's ability to exclude certain classes of employees—such as part-time employees—from these plans or to dictate the content of pension plans and other types of welfare plans. *See* Patient Protection and Affordable Care Act, Pub. L. No. 111-148, §§ 1511–1515, 124 Stat. 119, 252–58 (2010).

70 Pegram v. Herdrich, 530 U.S. 211, 225–26 (2000); Barnes v. Lacy, 927 F.2d 539, 544 (11th Cir. 1991).

71 *Johnson*, 19 F.3d at 1188.

72 Of course, this standard might not be the paradigm of employee protection, but Congress made it clear that "[t]he purpose of [ERISA] [was] not to establish an ideal pension plan but rather to set up minimum standards to prevent real abuses." 120 CONG. REC. 29,949 (1974) (statement of Sen. Bentsen).

pansion and improvement."[73] ERISA attempts to harmonize the competing goals of employee protection and employer freedom through section 502,[74] the remedial provision that provides a private right of action for relief under the statute.[75] This Note will next discuss the mechanics of bringing an action for misclassification.

B. Section 502 Actions: Part of the Balance

Under section 502(a)(1)(B) of ERISA, a "participant or beneficiary" may bring an action "to recover benefits due to [her] under the terms of [her] plan."[76] A participant is "any employee or former employee of an employer . . . who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer."[77] To achieve standing as a participant, a misclassified worker must prove that she satisfies the definition of a common law employee under *Nationwide Mutual Insurance Co. v. Darden*,[78] and meets the eligibility requirements prescribed by the plan.[79]

In *Darden*, the Supreme Court construed the meaning of the term "employee" under ERISA,[80] adopting the common law control test from agency law to distinguish employees from independent contractors.[81] The *Darden* test, similar to the IRS control test,[82] examines an array of factors to assess the hiring party's level of control over the worker.[83] In addition to satisfying *Darden*, the plaintiff must also prove her eligibility under the plan itself, which specifies the subset of

---

73 STAFF OF S. SPECIAL COMM. ON AGING, 98TH CONG., *supra* note 13, at 25.

74 *See* Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 54 (1987) ("[T]he detailed provisions of § 502(a) set forth a comprehensive civil enforcement scheme that represents a careful balancing of the need for prompt and fair claims settlement procedures against the public interest in encouraging the formation of employee benefit plans.").

75 *See* Employee Retirement Income Security Act (ERISA) of 1974 § 502, 29 U.S.C. § 1132 (2006).

76 *Id.* § 502(a)(1)(B), 29 U.S.C. § 1132(a)(1)(B).

77 *Id.* § 3(7), 29 U.S.C. § 1002(7). A beneficiary is "a person designated by a participant . . . who is or may become entitled to a benefit thereunder." ERISA § 3(8), 29 U.S.C. § 1002(8). This Note focuses on participants.

78 Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992).

79 *Id.* at 320–21, 323–24; Bauer v. Summit Bancorp, 325 F.3d 155, 160 (3d Cir. 2003).

80 ERISA provides: "the term 'employee' means any individual employed by an employer." ERISA § 3(6), 29 U.S.C. § 1006(6).

81 *Darden,* 503 U.S. at 321–23.

82 *See supra* note 4.

83 *Darden*, 503 U.S. at 323–24 (citing Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 751–52 (1989)). Besides analyzing "the hiring party's right to control" the work product, the Court considered, inter alia, "the source of instrumentalities and tools; the location of the work; . . . the extent of the hired party's discretion over when and how long to work; the method

employees covered by the plan.[84] A plan administrator, either the employer or a third party retained by the employer,[85] initially determines whether a misclassified worker meets plan eligibility criteria.[86] If the plan administrator excludes the misclassified worker from plan participation, the worker may bring a civil action after exhausting administrative remedies.[87]

Courts conduct a de novo review of the plan administrator's decision unless the plan document grants the administrator discretion to construe plan terms.[88] If the plan bestows such authority, the court reviews the administrator's decision under a deferential standard[89] and does not disturb the decision unless "it was without reason, unsupported by substantial evidence or erroneous as a matter of law."[90] Understandably, most plans confer discretion to administrators to take advantage of this deferential standard of review.[91]

When a misclassified worker sues to recover benefits, therefore, she has the uphill battle of proving that the plan administrator abused her discretion in excluding her from the plan. This task is often complicated by the existence of an ICA, a signed contract manifesting the worker's intent to be classified as an independent contractor. Part III explores the standards various courts have adopted to interpret the ICA within the context of an ERISA section 502 action. It also discusses the failure of these approaches to balance the underlying policy goals of ERISA.

---

of payment; [and] the hired party's role in hiring and paying assistants." *Id.* (internal quotation marks omitted).

84 *Bauer*, 325 F.3d at 160. By drafting the terms of the plan document, employers can freely limit coverage to a subset of employees, so long as the plan meets ERISA's minimum participation requirements. *See, e.g.*, Bronk v. Mountain States Tel. & Tel., Inc., 140 F.3d 1335, 1338 (10th Cir. 1998); Abraham v. Exxon Corp., 85 F.3d 1126, 1130 (5th Cir. 1996).

85 *See* ERISA § 3(16)(A), 29 U.S.C § 1002(16)(A) (defining plan administrator).

86 *See* Zanglein & Stabile, *supra* note 2, at 660 (detailing benefits denial process).

87 Exhaustion of remedies is implied by ERISA section 503, which requires plans to have a claims procedure. *Id.* at 377.

88 Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 115 (1989). To grant discretion, plan drafters must insert the following statement, or similar language, into the plan document: the administrator "has the sole discretionary authority to determine eligibility for participation or benefits and to interpret the terms of the Policy." Zanglein & Stabile, *supra* note 2, at 535 (internal quotation marks omitted).

89 *See* Zanglein & Stabile, *supra* note 2, at 534.

90 Fuller v. J.P. Morgan Chase & Co., 423 F.3d 104, 107 (2d Cir. 2005) (internal quotations marks omitted).

91 *See* Zanglein & Stabile, *supra* note 2, at 531.

III. Failing to Balance the Seesaw

Courts generally take one of two contradictory approaches when construing an ICA in an ERISA action: some wholly discount the contract and regard actual status as solely determinative,[92] while others view the ICA as the primary manifestation of the worker's intent.[93] Within the latter group, some courts go so far as to hold that the ICA precludes the receipt of plan benefits, regardless of the worker's status as a common law employee or participant under the plan.[94] This section outlines these incongruous approaches through an examination of *Vizcaino v. Microsoft Corp.*[95] and *Capital Cities/ABC, Inc. v. Ratcliff*,[96] two cases that have profound resonance in the misclassification context.[97]

A. Conflicting Standards

1. Vizcaino v. Microsoft Corp.

In *Microsoft*, workers designated as independent contractors by an ICA brought a section 502(a)(1)(B) action to recover benefits under Microsoft's employer-sponsored ERISA plan.[98] Microsoft compensated the workers through the accounts-payable department rather than through the payroll department, providing them a higher

---

92 *See* Vizcaino v. Microsoft Corp., 120 F.3d 1006, 1011–12 (9th Cir. 1997) (en banc); Sharkey v. Ultramar Energy Ltd., 70 F.3d 226, 232 (2d Cir. 1995); Daughtrey v. Honeywell, 3 F.3d 1488, 1492 (11th Cir. 1993); Barnard v. Advance Pension Plan, No. 06-6265-HO, 2008 WL 4838844, at *6 (D. Or. Nov. 4, 2008); Godshall v. Franklin Mint Co., 285 F. Supp. 2d 628, 633 n.5 (E.D. Pa. 2003); Gustafson v. Bell Atl. Corp., 171 F. Supp. 2d 311, 320 (S.D.N.Y. 2001).

93 *See* Estate of Suskovich v. Anthem Health Plans of Va., Inc., 553 F.3d 559, 564–65 (7th Cir. 2009); Trombetta v. Cragin Fed. Bank for Sav. Emp. Stock Ownership Plan, 102 F.3d 1435, 1440 (7th Cir. 1997).

94 *See* Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405, 1410–11 (10th Cir. 1998); Bendsen v. George Weston Bakeries Distrib., Inc., No. 4:08CV50 JCH, 2008 WL 4449435, at *4 (E.D. Mo. Sept. 26, 2008); Muller v. Am. Mgmt. Ass'n Int'l, 368 F. Supp. 2d 1166, 1174 (D. Kan. 2004); Kiper v. Novartis Crop Prot., Inc., 209 F. Supp. 2d 628, 637–38 (M.D. La. 2002), *aff'd*, 67 F. App'x 252 (5th Cir. 2003); Smith v. Torchmark Corp., 82 F. Supp. 2d 1006, 1010 (W.D. Mo. 1999).

95 Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997) (en banc).

96 Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405 (10th Cir. 1998).

97 *Microsoft*, in particular, has inspired copious amounts of legal scholarship, *see* Zanglein & Stabile, *supra* note 2, at 1407 n.60, and has spurred the creation of "Microsoft inoculation provisions," which employers draft into plan documents to circumvent *Microsoft*'s holding, *see infra* note 179 and accompanying text. *Microsoft* remains binding in the Ninth Circuit, *Barnard*, No. 06-6265-HO, 2008 WL 4838844, at *6, and *Capital Cities* remains binding in the Tenth Circuit, *Bendsen*, No. 4:08CV50 JCH, 2008 WL 4449435, at *4.

98 *Microsoft*, 120 F.3d at 1013. The plaintiffs also sued to recover benefits from a non-ERISA plan, but this Note focuses on the discussion of the ERISA plan. *Id.* at 1014.

hourly wage than its regular employees.[99] Moreover, the company distinguished the workers from regular employees by requiring them to wear different color ID badges, providing them different email addresses, and barring them from attending company functions.[100]

Despite these measures, the IRS reclassified the workers as employees for tax purposes, spurring them to file an ERISA suit.[101] In reviewing the workers' claims, the Ninth Circuit found that

> Microsoft fully integrated [the workers] into its workforce: they often worked on teams along with regular employees, sharing the same supervisors, performing identical functions, and working the same core hours. Because Microsoft required that they work on site, they received admittance card keys, office equipment and supplies from the company.[102]

In light of this overwhelming evidence, Microsoft conceded the status of the workers as common law employees, thus relieving the court from conducting a *Darden* analysis.[103] Instead, the issue of whether the workers were entitled to benefits turned on an interpretation of the ICA.

The court ultimately refused to enforce the ICA, finding that the "independent contractor" label contained in the contract was not determinative of the workers' status.[104] In fact, the court concluded that the label was meaningless, as it was premised upon the mutual mistake of both parties.[105] The terms of the ICA, therefore, could not effectively prevent the workers from receiving plan benefits.[106] Because the plan's administrative panel based its denial of benefits on the ICA, its decision represented an abuse of discretion.[107]

In reaching its conclusion, the court skirted the issue of intent. Although it meticulously detailed the bad faith actions Microsoft could have taken to mislabel its workers, it ultimately refused to probe whether Microsoft made knowing misclassifications.[108] Instead,

---

99 *Id.* at 1019 (O'Scannlain, J., dissenting).

100 *Id.*

101 *Id.* at 1008–09.

102 *Id.* at 1008 (internal quotation marks omitted).

103 *Id.* at 1009–10.

104 *Id.* at 1011.

105 *Id.* at 1012.

106 *Id.*

107 *Id.* at 1013.

108 *Id.* at 1010–11. For example, Microsoft could have "decided to manipulate the availability of . . . benefit[s] by routing the wages of . . . employees through the accounts payable department, so that it could argue that they were not on the United States payroll." *Id.* at 1010.

the court adopted a standard that invalidates an ICA regardless of an employer's underlying motive or knowledge.

2. *Capital Cities/ABC, Inc. v. Ratcliff*

One year after *Microsoft*, the Tenth Circuit adopted a wholly opposite approach in *Capital Cities/ABC, Inc. v. Ratcliff*, holding that the ICAs signed by the plaintiffs precluded them from receiving benefits under the employer's ERISA plan.[109] The court found that by signing the ICAs, the workers voluntarily agreed to relinquish plan benefits even though the contracts were presented to them on a "take-it-or-leave-it basis."[110] Like any other agreement, they were free to accept the terms or seek work elsewhere.[111]

Being voluntary agreements, the ICAs controlled over the workers' status as common law employees or plan participants.[112] In fact, the court found common law status to be immaterial, stating that "while the [workers'] affidavits contain many statements suggesting that [their employer] did not in fact treat them as independent contractors, that is actually irrelevant to the narrow question at issue in this case—namely, whether the [workers] voluntarily agreed that they would receive no benefits under the Plans."[113] By focusing on the employees' agreement to forego plan benefits, the court ignored the employer's intent, adopting a standard that validates an ICA notwithstanding an employer's knowing misclassification.

B. *A Uniform Problem with the Standards*

Although *Microsoft* and *Capital Cities* subject the employer to contradictory standards, they share a common thread: both approaches fail to distinguish between good and bad faith employers. The next Subsection describes the critical differences between these two categories of employers. It then explains how *Microsoft* and *Capital Cities*, by failing to probe the underlying intent of the employer, upset the delicate equilibrium between employee protection and employer freedom achieved by ERISA.

---

109 Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405, 1410–11 (10th Cir. 1998).

110 *Id.*

111 *Id.*

112 *Id.*

113 *Id.* at 1410.

1. *Good Faith vs. Bad Faith Employers*

Not all employers who misclassify their employees abuse the employee-benefits system. Like Letter of the Law and Cutting Corners, companies generally can be divided into two categories: good faith employers, who inadvertently misclassify, and bad faith employers, who knowingly misclassify.

Employers who inadvertently misclassify make good faith efforts to abide by the common law control test, which represents a complex confluence of differently weighted factors.[114] Moreover, employers must interpret multiple control tests to classify workers in the employee-benefits context; in addition to *Darden*, the tax code compels employers to apply the IRS's twenty-factor test.[115] Given the ambiguity of the tests, even the Joint Committee on Taxation admits that "reasonable people may differ as to the correct result."[116] Notwithstanding the difficulty of the task, the good faith employer makes bona fide efforts to construe the control tests.[117] In doing so, it most likely relinquishes some level of control over the workers, providing them a benefit for their freelancer status. Although the good faith employer is ultimately mistaken as to the outcome, it provides some degree of autonomy to its workers and makes honest efforts to navigate the highly complex misclassification framework.

By contrast, the bad faith employer intentionally disregards the requirements of the control tests, appending the label of "independent contractor" to employees without relinquishing any control over the workers.[118] In such a situation, the workers suffer on two fronts: they lose the autonomy typically afforded freelancers and the statutory protections and plan benefits provided to employees.[119] The bad faith employer seizes upon the control tests' ambiguities to benefit from the contingent work arrangement without incurring any of the attendant costs.[120]

---

114 *See* Carlson, *supra* note 3, at 338–53; Robert W. Wood, *Independent Contractor vs. Employee and Blackwater*, 70 MONT. L. REV. 95, 97–98 (2009); Hixon, *supra* note 51, at 682.

115 *See supra* note 4.

116 STAFF OF THE JOINT COMM. ON TAXATION, 100TH CONG., *supra* note 31, at 8.

117 *See* Boles Trucking, Inc. v. United States, 77 F.3d 236, 239 (8th Cir. 1996) (stating that the IRS safe harbor was passed to provide relief for "employers who had, in good faith, misclassified their employees as independent contractors").

118 *See* Mark Berger, *Rethinking the Legal Oversight of Benefit Program Exclusions*, 33 RUTGERS L.J. 227, 240 (2002).

119 *See supra* notes 23–28 and accompanying text.

120 *See* Hixon, *supra* note 51, at 684–85.

Many federal and state laws that attack the problem of misclassification recognize the distinction between good and bad faith employers. As discussed previously, the IRS provides a safe harbor to those employers who, among other things, had a good faith basis for their mistake.[121] Additionally, many state laws impose more severe penalties on bad faith employers than their good faith counterparts.[122] Courts interpreting benefits claims in the ERISA context, however, often fail to distinguish between these categories of employers. *Microsoft* and *Capital Cities* exemplify the problem: regardless of the employer's underlying intent, *Microsoft* uniformly abrogates the ICA, punishing all employers alike,[123] while *Capital Cities* uniformly upholds the ICA, rewarding all employers alike.[124]

In treating all employers the same, *Microsoft* and *Capital Cities* disturb the ERISA seesaw, a carefully constructed balance between employee protection and employer freedom achieved by the statute. *Microsoft*, which punishes good faith employers engaged in arm's-length transactions, tips the seesaw toward employee protection. By contrast, *Capital Cities*, which rewards bad faith employers that abuse the benefits system, tips it toward employer freedom. The next Subsection further explores the imbalance resulting from both approaches.

2. *Failing to Balance Employee Protection and Employer Freedom*

a. Microsoft*: Tipped Toward Employee Protection*

By disregarding the ICA, *Microsoft* promotes employee protection at the expense of employer freedom, permitting workers to recover benefits despite their contractual agreement to forego them. In adopting this approach, *Microsoft* overlooks three important points: first, when requiring a worker to sign an ICA, an employer is wearing its employer hat, which enables it to engage in arm's-length transactions; second, by signing an ICA, a worker manifests her intent to be classified as an independent contractor, a designation which may provide her desired benefits; and third, voiding the ICA shifts unexpected costs to employers, which invariably harms all workers.

---

121 *See supra* note 8 and accompanying text.

122 *See supra* notes 9–10 and accompanying text; *see also* DEL. CODE. ANN. tit. 19, § 3503(e) (2010); 820 ILL. COMP. STAT. 185/45 (2009); MINN. STAT. § 181.722 subdiv. 1 (2009); N.J. STAT. ANN. § 34:20-5a(2) (West 2010).

123 Vizcaino v. Microsoft Corp., 120 F.3d 1006, 1011 (9th Cir. 1997) (en banc).

124 Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405, 1410–11 (10th Cir. 1998).

i. Employer Hat

At the time an ICA is signed, an employer does not act in its fiduciary capacity and, instead, participates in an arm's-length transaction with a prospective hire.[125] An employer is free to negotiate, and even dictate, the terms of the work relationship.[126] Accordingly, it has the discretion to prescribe, via contract, whether a worker will receive employee benefits. ERISA similarly permits employers to design plan documents excluding whomever they want from plan coverage, provided they adhere to minimum participation requirements.[127] Whether an employer drafts an ICA or the terms of an ERISA plan, it makes decisions regarding the scope of benefits coverage and thus wears its employer hat. *Microsoft*, by uniformly invalidating the ICA, intrudes upon this traditional employer sphere. This intrusion could discourage employers, fearful of excessive regulation, from establishing benefit plans in the first place.

Detractors from the employer-hat approach might criticize the "take-it-or-leave-it" nature of the ICA. This characteristic, however, "does not in and of itself render the agreement unenforceable."[128] Employers offer other standard terms of the work relationship, including salary levels, on a similar basis. An employer is entitled to dictate its worker's compensation, including the form in which it is offered,[129] and *Microsoft*'s harsh standard interferes with this discretion.

Proponents of the *Microsoft* approach might argue that its incursion into the employer's traditional area of discretion is justified; employers should not be able to exclude plan participants through the "largely secretive process of securing individual employment agreements."[130] Instead, employers should be required to amend plan eligibility criteria to restrict plan membership.[131] Nothing in ERISA,

---

125 *See* Pegram v. Herdrich, 530 U.S. 211, 225 (2000) (stating that ERISA only requires an employer to wear its "fiduciary hat when making fiduciary decisions").

126 *See id.* (stating that employers, who might be ERISA fiduciaries in other contexts, are allowed to "take actions to the disadvantage of [their workers], when they act as employers").

127 *See, e.g.*, Bronk v. Mountain States Tel. & Tel., Inc., 140 F.3d 1335, 1338 (10th Cir. 1998) (explaining that "[i]t is well established that ERISA does not prohibit an employer from distinguishing between groups or categories of employees"); Abraham v. Exxon Corp., 85 F.3d 1126, 1130 (5th Cir. 1996) (explaining that ERISA "does not prevent employers from denying participation in an ERISA plan if the employer does so on a basis other than age or length of service"); *see also supra* note 57 (describing the minimum participation requirements).

128 Berger, *supra* note 118, at 253.

129 *Id.*

130 *Id.* at 257.

131 *Id.*

however, prohibits two parties from contractually limiting the rights of an individual who would otherwise be eligible to participate under a plan.[132]

This, however, raises the question: can an employer contractually limit the rights of a worker under the auspices of an ICA when, in fact, the worker is a common law employee?

Ultimately, the employer-hat approach ignores employers who intentionally structure the employment relationship to misclassify workers in complete derogation of the control-test standards. Accordingly, the theory should not be extended to protect abusive behavior, a contention that will be explored more fully in Part III.B.2.b.

ii. The Employee's Side of the Story

Not only does *Microsoft* constrain the employer's discretion to prescribe the terms of the work agreement, it also ignores the worker's role in establishing the contractual relationship. Congress designed ERISA to protect employees with "anticipated [plan] benefits;"[133] by signing an ICA, a worker voluntarily relinquishes plan benefits, extinguishing her expectation to receive anything from the plan.[134] Ignoring a worker's manifestation of intent might be logical in the setting of an IRS determination, where the government is not bound by a contract to which it is not a party, but it is harder to justify in the context of an ERISA action brought by one of the contracting parties.

Moreover, *Microsoft* is premised on the myth that the freelancers received nothing in exchange for their designated status and could never have intended to relinquish benefits. In actuality, the independent contractor label provides its own set of advantages. An employer could recompense its workers in ways other than plan benefits and, in fact, the *Microsoft* freelancers received higher hourly wages than their employee counterparts.[135] Indeed, many independent contractors seek out the relationship. According to a 2005 Department of Labor study, fewer than ten percent of independent contractors re-

132 *See, e.g.*, Laniok v. Advisory Comm. of the Brainerd Mfg. Co. Pension Plan, 935 F.2d 1360, 1364–65 (2d Cir. 1991) (holding that an employee may waive his or her right to participate in a pension plan).

133 Employee Retirement Income Security Act (ERISA) of 1974 § 2(a), 29 U.S.C. § 1001(a) (2006) (finding that "many employees with long years of employment are losing anticipated retirement benefits" and providing for the protection of those employees).

134 Hixon, *supra* note 51, at 701–02.

135 Vizcaino v. Microsoft Corp., 120 F.3d 1006, 1019 (9th Cir. 1997) (en banc) (O'Scannlain, J., dissenting).

ported that they would prefer a traditional work arrangement.[136] Many freelancers favor the autonomy their status provides over employer-provided benefits, especially if they are covered by a spouse's plan or their own tax-sheltered pension fund.[137] In some instances, an employer hires independent contractors to accommodate the workers' preferences. In *Kiper v. Novartis Crop Protection, Inc.*,[138] for example, the workers signed ICAs so that the employer would pay them directly instead of paying their leasing agency.[139] By uniformly abrogating the ICA, regardless of the parties' underlying bargain, the *Microsoft* approach allows shrewd plaintiffs to receive unanticipated benefits notwithstanding the advantages they gained from foregoing benefits in the first place.

Some commentators have argued that misclassified workers cannot manifest a legitimate intention to relinquish plan benefits because they were never aware of their potential eligibility to receive benefits.[140] Individuals, however, routinely waive rights to which they may or may not become entitled.[141] Independent contractors might, in fact, forfeit potential plan eligibility as consideration for the advantages attendant to their freelancer status.

This forfeiture, however, presents a problem when freelancers receive nothing in exchange for their status, which occurs when bad faith employers classify workers as independent contractors without relinquishing control over their work product. *Microsoft* does not adequately address this problem because it abrogates all ICAs, regardless of the benefits provided to the misclassified worker under them. The rule espoused by *Microsoft* is too broad, subverting the worker's intent regardless of the underlying bargain.

iii. Workers with Expectations to Benefits

Conferring benefits on misclassified workers favors individuals who voluntarily agreed to forego plan benefits at the expense of estab-

136 News Release, Bureau of Labor Statistics, *supra* note 17, at 4.

137 *See supra* notes 31–32 and accompanying text.

138 Kiper v. Novartis Crop Prot., Inc., 209 F. Supp. 2d 628 (M.D. La. 2002), *aff'd*, 67 F. App'x 252 (5th Cir. 2003).

139 *Id.* at 631, 638 (holding that the ICA estopped plaintiffs' claims to receive plan benefits). The freelancers also received markup fees that the employer was originally paying to the leasing agency. *Id.* at 631.

140 Recent Case, Vizcaino v. Microsoft Corp., *120 F.3d 1006 (9th Cir. 1997) (en banc)*, 111 HARV. L. REV. 609, 613 (1997); *see also* Berger, *supra* note 118, at 251.

141 *See, e.g.*, Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 35 (1991) (upholding prospective waiver of judicial forum for an Age Discrimination in Employment Act claim).

lished plan participants.[142] When a worker prevails in an ERISA section 502(a)(1)(B) action, the court imposes unexpected liability on the employer, who may, acting rationally, shift the cost to other market participants. Plan participants, employees who reasonably expect to receive benefits under the plan,[143] may be forced to absorb this unforeseen liability. Along with traditional cost-cutting measures, such as lowering wages and cutting the work force, the employer might limit plan contributions or, in the extreme, terminate welfare plans or nonvested pension funds.[144]

Concern for these types of cost-shifting consequences permeates ERISA caselaw.[145] In another context, courts consistently refuse to entertain the validity of oral representations made by plan administrators if enforcing these promises would jeopardize fund payments to other beneficiaries.[146] According to one court, enforcing these claims "would threaten the stability and solvency of many plans upon which so many other employees are dependent."[147] The same reasoning applies to claims propounded by misclassified workers. Courts should be hesitant to legitimize benefits claims made by these workers, fearful that they would endanger the ability of established participants to receive promised plan benefits.[148]

One might argue that denying these workers plan benefits deprives them of a vital source of retirement income, leaving critical coverage gaps in the country's population.[149] Although this policy argument seems sound, it overlooks the fact that Congress, when enacting ERISA, explicitly recognized that employer-provided benefit plans would supply only one source of retirement funding.[150] Additional income would be provided through Social Security benefits and the individual retirement account ("IRA"), which Congress estab-

---

142 *See* Hixon, *supra* note 51, at 704–05.

143 *See id* at 704.

144 *See* Lockheed Corp. v. Spink, 517 U.S. 882, 891 (1996) (finding that an employer does not act as a fiduciary when amending a plan); Johnson v. Ga.-Pac. Corp., 19 F.3d 1184, 1188 (7th Cir. 1994) (stating that the employer is free to "adjust myriad . . . details of pension plans, and may decide to terminate the plan altogether").

145 *See* JOHN H. LANGBEIN ET AL., PENSION AND EMPLOYEE BENEFIT LAW 693 (4th ed. 2006).

146 *Id.* at 691.

147 Degan v. Ford Motor Co., 869 F.2d 889, 895 (5th Cir. 1989).

148 This is especially the case for pay-as-you-go welfare plans, where payments come directly from the employer rather than an independent trust fund.

149 *See* Berger, *supra* note 118, at 269–70.

150 *See* 120 CONG. REC. 29,947 (1974) (statement of Sen. Curtis); *id.* at 29,951–52 (statement of Sen. Bentsen); *see also* Hixon, *supra* note 51, at 668.

lished to facilitate retirement savings for individuals not participating in employer-sponsored plans.[151]

Although the number of workers lacking retirement security is alarming indeed, the harsh reality is that ERISA does not require employers to provide pension plans. Many employers, especially small business owners, simply cannot afford to provide benefits to all workers.[152] These employers may hire freelancers to reduce costs, allowing them to maintain benefit levels for current plan participants. ERISA, which primarily protects employees with anticipated benefits, promotes this allocation of resources.

Microsoft contravenes this policy goal by favoring misclassified workers at the expense of established plan participants. Although the holding of *Microsoft* is too broad because it invalidates the ICA regardless of the parties' underlying intent, the court's rationale should not be wholly discounted. *Microsoft*, for example, punishes employers who knowingly use the ICA as a tool to misclassify workers. The next Subsection discusses *Capital Cities*' failure to restrict this abusive practice.

b. Capital Cities*: Tipped Toward Employer Freedom*

Although courts should generally respect the manifestation of intent articulated in the ICA, the Tenth Circuit's rigid adaptation of this approach in *Capital Cities* skews too far in favor of employer freedom. Courts following *Capital Cities* would uphold the ICA even where it is used as a tool to skirt the law and make knowing misclassifications. This outcome contravenes one of ERISA's primary purposes—remedying pension abuse. Moreover, it ignores three critical points: first, the ICA must be interpreted in conjunction with ERISA's protective purview; second, ERISA, although primarily protective of established plan participants, also benefits multiple actors in the employment relationship; and third, Congress intended ERISA to resolve future issues involving rights and obligations under employer-sponsored benefit plans.

---

151 *See* 120 CONG. REC. 29,951–52 (statement of Sen. Bentsen). An IRA is a "trust created . . . for the exclusive benefit of an individual," I.R.C. § 408(a) (2006), into which she can make tax-exempt retirement contributions, *id.* § 408(e)(1).

152 *See* Judson D. Stelter, Note, *The IRS' Classification Settlement Program: Is It an Adequate Tool to Relieve Taxpayer Burden for Small Businesses that Have Misclassified Workers as Independent Contractors?*, 56 CLEV. ST. L. REV. 451, 452–53 (2008).

i. Interpreting the ICA Within ERISA

When interpreting ICAs, judges must remember that they are applying contract-law principles *within the context of an ERISA section 502 action*. The Supreme Court recognizes that in the ERISA setting, traditional doctrine must sometimes yield to the protective scheme of the statute. For example, although the Court interprets much of ERISA's provisions in accordance with trust-law principles, it has stated that "trust law does not tell the entire story. After all, ERISA's standards and procedural protections partly reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection."[153] Thus, when analyzing fiduciary breach claims brought under ERISA, courts must depart from trust-law doctrine when necessary to uphold ERISA's statutory purpose.[154]

Similarly, pure application of contract law also failed to safeguard employees from pension-plan default. When the Studebaker pension plan defaulted in 1963,[155] plan participants lacked recourse because, pursuant to the contract negotiated between the employer and the participants' union, the pension promise ran from the plan rather than the employer.[156] Participants, therefore, could only recover damages from the plan itself, which lacked sufficient funds to make full payments.[157] Contract law's failure to protect employees from pension abuse, as illustrated by the Studebaker incident, necessitated the enactment of ERISA, which was designed to offer more protection than contract law could afford.[158] Accordingly, when interpreting the ICA within the context of an ERISA action, courts must not ignore ERISA's protective purview in favor of strict contract interpretation principles.

ii. ERISA Benefits Multiple Actors

Although ERISA primarily safeguards established plan participants, courts must not wholly discount misclassified workers when interpreting ICAs. In enacting ERISA, Congress did not completely "disregard [the] 20 million workers [not covered by employer-sponsored plans]."[159] According to Senator Curtis, Congress intended ER-

153 Varity Corp. v. Howe, 516 U.S. 489, 497 (1996).

154 *Id.*

155 *See supra* note 53.

156 LANGBEIN ET AL., *supra* note 145, at 77.

157 *Id.*

158 *See* Hixon, *supra* note 51, at 672–74, 674 n.36.

159 120 CONG. REC. 29,949 (1974) (statement of Sen. Bentsen).

ISA to "benefit everyone—employees, employers . . . and other self-employed."[160] In analyzing a misclassified worker's claim, therefore, courts must bear in mind that ERISA benefits multiple actors.

Misclassified workers improperly labeled by bad faith employers have a particularly compelling argument that ERISA's protective provisions should cover them. Under the guise of an ICA, bad faith employers affixed the independent contractor label to the workers without providing remuneration for forfeited benefits. Congress enacted ERISA to remedy similar types of abuse, including employers using unscrupulous tactics to deprive workers of retirement income.[161] Certainly, ERISA's framers would not have intended workers who would otherwise fall under the statute's purview to be denied relief simply because an employer's bad faith actions took them out of this purview. This would reward the abuser, an outcome clearly contrary to ERISA's purpose. Accordingly, courts must heed the rights of misclassified workers, particularly when they would be plan participants but for the bad faith efforts of their employers.

iii. ERISA as Exclusive Regulator

Not only does ERISA aim to remedy abuse in the pension system, it also federalizes the field of private, benefit-plan regulation, wholly preempting state laws related to employer-sponsored plans.[162] In response to concerns that ERISA would supersede state laws designed to protect participants, Senator Javits stated: "It is . . . intended that a body of [f]ederal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans."[163] Thus, Congress fully intended courts to fashion federal common law to address emerging issues in the employee-benefits arena.[164] Moreover, the Supreme Court has admonished courts to consider the dual policy goals of ERISA when devising such law, one of these goals being the enhanced protection of employees' pension-plan benefits.[165]

---

160 *Id*. at 29,947 (statement of Sen. Curtis).

161 *See supra* notes 51–52 and accompanying text.

162 *See* Employee Retirement Income Security Act (ERISA) of 1974 § 2(a), 29 U.S.C. § 1001(a) (2006); *supra* text accompanying note 63; *supra* note 64 and accompanying text.

163 120 CONG. REC. 29,942 (statement of Sen. Javits).

164 *See* Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110 (1989) (stating that Congress expected courts to "develop a 'federal common law of rights and obligations under ERISA-regulated plans'" when interpreting ERISA's fiduciary standards (quoting Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 56 (1987))).

165 *See* Varity Corp. v. Howe, 516 U.S. 489, 497 (1996).

A new threat to pension-plan benefits has emerged in the employment landscape: the knowing misclassification of employees. Misclassification is the type of issue Senator Javits intended courts to address when he stated that "[f]ederal substantive law will be developed" to deal with issues involving pension plans.[166] Knowing misclassification strips employees of plan benefits to which they might otherwise be entitled, thereby thwarting the protective intent of ERISA. According to the findings of a 2000 bill sponsored by Senator Edward Kennedy, the goals underlying ERISA are "frustrated by the practice of mislabeling employees to improperly exclude them from employee benefit plans."[167] Additionally, misclassification is similar to the type of abuse initially addressed by ERISA: both harms involve bad faith employers who intentionally deprive workers of plan benefits.

Finally, as illustrated by Senator Javits's statement, Congress enacted ERISA's sweeping preemption provisions, in part, because it expected federal law to the fill gaps created by the displacement of state law.[168] In the misclassification context, state regulations providing mislabeled workers the statutory right to recover lost benefits would be superseded by ERISA.[169] ERISA preemption thus creates a regulatory vacuum with respect to misclassification. Courts such as the Tenth Circuit decline to fill this vacuum, in complete derogation of Senator Javits's challenge to the judiciary.[170]

In response, one might argue that the Supreme Court, through an established line of precedent, has consistently abstained from filling statutory gaps created by ERISA preemption.[171] In fact, by broadening the preemption's scope and limiting ERISA's remedies, the Court has exacerbated the problem,[172] often leaving plan participants "'without remedies for fraud and overreaching conduct.'"[173] Many legal scholars, however, denounce the Court's jurisprudence as contraven-

---

166 120 CONG. REC. 29,942 (statement of Sen. Javits).

167 Employees Benefits Eligibility Fairness Act, S. 2946, 106th Cong. § 2(a)(1) (2000).

168 *See supra* note 163 and accompanying text.

169 *See* Aetna Health Inc. v. Davila, 542 U.S. 200, 217–18 (2004) (explaining that a "[s]tate law . . . will be pre-empted if it provides a separate vehicle to assert a claim for benefits outside of, or in addition to, ERISA's remedial scheme").

170 *See, e.g.*, Capital Cities/ABC, Inc. v. Ratcliff, 141 F.3d 1405, 1410–11 (10th Cir. 1998) (denying workers' claim for benefits under section 502).

171 *See* Paul M. Secunda, *Sorry, No Remedy: Intersectionality and the Grand Irony of ERISA,* 61 HASTINGS L.J. 131, 137–46 (2009) (providing overview of ERISA preemption cases).

172 *Id.* at 131, 133.

173 Parra v. John Alden Life Ins. Co., 22 F. Supp. 2d 1360, 1365 (S.D. Fla. 1998) (quoting Suggs v. Pan Am. Life Ins. Co., 847 F. Supp. 1324, 1357–58 (S.D. Miss. 1994)).

ing ERISA's protective intent.[174] The problem of misclassification should be addressed within ERISA itself, notwithstanding the Court's previous failure to plug regulatory holes created by preemption.

The Court's stance does create some concerns; for example, the federal judiciary may not be receptive to developing federal common law remedies. To address this concern, this Note suggests an amendment to ERISA as the solution best able to rectify the problem of misclassification. The next Part discusses this Note's proposed amendment, which aims to balance the dual policy goals of ERISA, and further explains why an amendment is necessary to curb abuse in the pension system.

IV. Balancing the Seesaw

Both *Microsoft* and *Capital Cities* fail to balance employer freedom and employee protection in the employee benefits context, thus disrupting the equilibrium achieved by ERISA.[175] Striking a balance between these competing principles requires a consistent standard that distinguishes between good and bad faith employers. This Note proposes amending ERISA to make it a violation for an individual to *knowingly* misclassify employees. This solution respects employer freedom, by retaining the ability of good faith employers to enter into arm's-length bargains with independent contractors, yet preserves employee protection, by preventing bad faith employers from knowingly misclassifying workers to deprive them of plan benefits.

Additionally, although the amendment would specifically target abuse by distinguishing between good and bad faith employers, it would also be broad enough to capture all types of abuse. The next Section explains why an amendment is necessary to remedy all forms of abuse. Finally, the Note details the provisions of the amendment and how courts should interpret it within the context of a section 502 action.

A. *Remedying All Forms of Abuse*

Amending ERISA to circumscribe knowing misclassification is the solution best equipped to capture the various ways employers abuse the benefits system. Other solutions fail to reach all forms of abuse. Under one such proposal, courts would clarify the standard

---

174 *See* Richard Rouco, *Available Remedies Under ERISA Section 502(a)*, 45 Ala. L. Rev. 631, 632–33 (1994); Secunda, *supra* note 171, at 133–34.

175 *See supra* notes 15–16 and accompanying text.

used to interpret ICAs in an ERISA section 502 action.[176] Indeed, this solution heeds Senator Javits's original vision, which foresaw the development of federal common law to plug the gaps created by ERISA preemption.[177] To remedy abuse, courts would invalidate the ICA, rendering the plaintiff's contractual agreement to forego plan benefits unenforceable, upon a showing of knowing misclassification.[178]

Voiding the ICA, however, fails to prevent employers from misclassifying employees through arbitrary exclusions in the plan document. To illustrate, employers could draft "*Microsoft* Inoculation Provisions," which preclude misclassified workers from participating in employer-sponsored plans even where they have been reclassified by the court or the IRS.[179] Furthermore, the plan document could restrict benefits to "a [s]alaried [e]mployee on the payroll of [the employer]," an exclusion that permits employers to misclassify by paying employees through their accounts-payable department.[180] Because ERISA affords employers discretion over the drafting of plan documents, many courts uphold these provisions.[181] Even if the worker is reclassified as a common law employee under *Darden*, the terms of the plan document control, preventing her receipt of benefits.[182]

Bad faith employers could also shield themselves from court intervention by granting plan administrators discretion in the plan document, which requires courts to adopt a deferential standard when reviewing benefit denials.[183] Deferential review allows administrators to deny coverage to misclassified workers even where plan documents do not explicitly spell out such exclusions. For example, in *Kolling v. American Power Conversion Corp.*,[184] the court upheld an administra-

176 *See supra* note 163 and accompanying text.

177 The proposed Employee Benefits Eligibility Fairness Act of 2000, S. 2946, 106th Cong. (2000), adopted a version of this approach. This bill abrogated the ICA in the case of any misclassification, whether intentional or inadvertent. *Id.* § 4(d).

178 *See id.*

179 These provisions, which were developed in response to *Microsoft*, typically exclude "all independent contractors . . . even if it is subsequently determined by a court or the Internal Revenue Service that such individuals should be, or should have been, properly classified as common law employees of the employer." Jaeger v. Matrix Essentials, Inc., 236 F. Supp. 2d 815, 825 (N.D. Ohio 2002) (internal quotation marks omitted); *see also* Pearson v. AT&T Pension Benefit Plan, No. 06 C 2899, 2007 WL 2875630, at *2 (N.D. Ill. Sept. 28, 2007).

180 Gustafson v. Bell Atl. Corp., 171 F. Supp. 2d 311, 321 (S.D.N.Y. 2001) (citing Admin. Comm. of the Time Warner, Inc. Benefit Plans v. Biscardi, No. 99 Civ. 12270, 2000 WL 1721168, at *9 (S.D.N.Y. Nov. 17, 2000)).

181 *Id.*

182 *Id.*

183 *See supra* notes 88–90 and accompanying text.

184 Kolling v. Am. Power Conversion Corp., 347 F.3d 11 (1st Cir. 2003).

tor's decision that a plan did not cover a misclassified worker because he was not given a Form W-2 by his employer.[185] Similarly, in *Scruggs v. ExxonMobil Pension Plan*,[186] the court found that an administrator's denial of benefits was not arbitrary and capricious even though it was premised solely on the worker's receipt of payment through accounts payable rather than payroll.[187] These decisions permit administrators to deny plan benefits based on an employer's arbitrary misclassification and thus fail to remedy employer abuse.

Another solution advocated by courts and commentators, the adoption of a waiver analysis, also fails to capture all forms of knowing misclassification.[188] Under a waiver standard, courts uphold a misclassified worker's agreement to forego plan benefits only if she made a "knowing and voluntary" decision.[189] Even if a court invalidates the employee's waiver, however, the employer can still misclassify the worker by manipulating the terms of the plan document and granting the plan administrator discretion to make benefits denials. Therefore, the waiver analysis fails to obviate employer abuse of the pension system.

To remedy pension abuse, any proposed solution must completely abrogate the employer's ability to make knowing misclassifications. The solution must extend beyond merely invalidating the ICA; instead, it must constrain an employer's ability to make arbitrary exclusions in the plan document. This Note suggests amending ERISA, adding a provision that proscribes knowing misclassification regardless of the means used to achieve it. The next Section outlines the details of the recommended amendment.

B. *The Amendment*

This Note proposes the following amendment to the statutory scheme of ERISA:

> It shall be unlawful for any person to knowingly misclassify an individual if the misclassification results in the deprivation of benefits to which such individual may have otherwise become entitled under an employee benefit plan. An unlawful misclassification may include, but is not limited

185 *Id.* at 14–15.

186 Scruggs v. ExxonMobil Pension Plan, 585 F.3d 1356 (10th Cir. 2009).

187 *Id.* at 1365.

188 *See, e.g.*, Yak v. Bank Brussels Lambert, 252 F.3d 127, 131 (2d Cir. 2001); Recent Case, *supra* note 140, at 614.

189 *See* Laniok v. Advisory Comm. of the Brainerd Mfg. Co. Pension Plan, 935 F.2d 1360, 1367 (2d Cir. 1991).

> to, exclusions in the written benefit plan. Any person who violates this section shall be required to furnish to the misclassified individual the benefits that would have otherwise been available under the plan. The provisions of section 502 [29 U.S.C. § 1132] shall be applicable in the enforcement of this section.

To supplement this amendment, the following definitions should be added to section 3 [29 U.S.C. § 1002]:

> The term "misclassify" means to classify an individual as any status other than an employee if the individual is an employee under section 3(6) of this statute.
>
> The term "knowingly" means that an individual is aware, or should be aware if acting with reasonable care and diligence, that his actions are likely to cause a prohibited result. Knowledge of unlawfulness is not necessary.

The definition for "misclassify" makes reference to the term "employee," which is defined in section 3(6) of the statute as "any individual employed by an employer."[190] In *Darden*, the Supreme Court adopted the common law control test to clarify this circular statutory definition.[191]

Finally, section 502, the enforcement provision of ERISA, must be amended to take account of the new section. Currently, section 502(a) states:

> A civil action may be brought (1) by a participant or beneficiary (A) for the relief provided for in subsection (c) of this section, or (B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan.[192]

Section 502(a)(1)(C) must be added and should read: "for the relief provided for under [the proposed amendment] of this title." Adding section 502(a)(1)(C) would entitle an individual to bring a civil action to recover the relief outlined in the proposed amendment.

The proposed amendment, unlike the solutions discussed above, wholly vitiates the bad faith employer's ability to mislabel its workers. Not only does it proscribe knowing misclassifications made through an ICA, but it also expressly prohibits misclassifications made through

---

190 Employee Retirement Income Security Act (ERISA) of 1974 § 3(6), 29 U.S.C. § 1002(6) (2006).

191 *See supra* notes 80–83 and accompanying text.

192 ERISA § 502(a), 29 U.S.C. § 1132(a).

exclusions in the written plan. Thus, the amendment trumps the traditional deference afforded employers in the area of plan design.

Furthermore, the amendment frees courts from the restraints of a deferential standard of review, which only applies to the review of benefits denials in a section 502(a)(1)(B) action.[193] Under newly added section 502(a)(1)(C), courts need not defer to a plan administrator's decision concerning a misclassified worker's entitlement to benefits. Courts, instead, would conduct a de novo review to determine whether an employer knowingly misclassified a plaintiff. The next Section further explores how courts would conduct such a review.

C. *Interpreting the Amendment*

To prevail under a section 502(a)(1)(C) action, a misclassified worker would be required to prove, by a preponderance of evidence, that (1) she is a common law employee under the *Darden* test, (2) her employer knowingly misclassified her as an independent contractor, and (3) she would have been entitled to participate in her employer's ERISA plan but for the misclassification.[194] This Note will focus on explaining the second factor of the test, the most difficult element to prove.

1. *Proving Knowledge: Factors Courts Should Consider*

Under the proposed amendment, "knowingly" means having actual or constructive knowledge. Actual knowledge may be proved by the prototypical smoking-gun statement, e.g., the interoffice memo discussing the misclassification. Absent such a statement, however, a plaintiff must use circumstantial evidence to demonstrate knowledge on the part of her employer.

To prove knowledge through circumstantial evidence, a plaintiff can compare her role in the company to the role of current or former employees participating in an employer-sponsored plan. An employer possesses knowledge that an individual covered under its plan is an employee for benefit purposes. Accordingly, if the same employer

193 *See* Metro. Life Ins. Co. v. Glenn, 554 U.S. 105, 110–11 (2008) (explaining that *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989), requires courts to adopt a deferential standard in the context of a section 502(a)(1)(B) action where a plan grants its administrator discretionary authority to make benefits decisions); Bruch, 489 U.S. at 108 (limiting its holding "to the appropriate standard of review in [section 502(a)(1)(B),] § 1132(a)(1)(B)[,] actions challenging denials of benefits based on plan interpretations").

194 In analyzing this factor, courts should discount plan terms designed to create arbitrary exclusions, such as provisions that require a plan participant to receive a Form W-2 or to be paid through the payroll department.

treats the plaintiff like a covered employee in all functional aspects except entitlement to benefits, the inference can be made that the employer knowingly misclassified the plaintiff. The plaintiff may show: (1) the employer treated any individual holding a *substantially similar* position to the plaintiff as an employee for benefit purposes; or (2) the IRS determined that an employee holding a *substantially similar* position to the plaintiff was misclassified prior to the plaintiff's misclassification.

Knowledge, therefore, turns on whether the plaintiff holds a substantially similar position to a covered employee. In conducting the "substantially similar" test, courts must examine the underlying facts of a given work relationship, weighing the similarities and differences between the plaintiff and covered employees. If, after the balance is conducted, the totality of similarities outweighs the totality of differences, the plaintiff can prove that the employer treated her as functionally equivalent to a covered employee and thus knowingly misclassified her as an independent contractor. The next Subsection examines the factors to weigh in conducting the substantially similar analysis.

a. *Weighing the Factors: A Brief Overview*

The factors fit into three broad categories of similarities and differences: functional, de minimis, and artificial. Courts should primarily weigh functional similarities against functional differences when comparing two workers. Courts should also note, but refrain from giving much weight to, de minimis similarities. De minimis factors should only sway the outcome if they significantly outnumber the amount of functional factors. Finally, courts should wholly discount artificial factors when conducting the inquiry.

Within the functional category, not all similarities should be weighed equally. These factors fit into four subcategories of descending order of importance: control and supervision, job function, access to resources, and compensation. Generally, courts should give more weight to control factors unless the other three categories of functional factors collectively outnumber them. When weighing multiple factors within a particular category or subcategory, courts should favor factors bearing more directly on an individual's ability to control her work product (even if they do not formally fit into the control category). The next Subsection gives context to these general standards through an exploration of the functional, de minimis, and artificial factors.

b. Functional Factors

i. Control and Supervision

Control is the factor of primary importance. Courts should compare the level of control both the plaintiff and the covered employee have over the manner and means by which they perform their work. Specific factors include: whether both work comparable hours or have similar abilities to set their work schedule; whether both report to the same location; and whether both receive the same degree of daily supervision, including having identical supervisors.[195] Additionally, courts should examine whether both have comparable abilities to hire assistance or to pursue outside work.

ii. Job Function

After weighing control similarities, courts should focus on the workers' specific job functions, including whether they perform functionally equivalent tasks. When making this inquiry, courts must consider the underlying nature of the task, not the superficial assignment. For example, a worker who sells medical equipment to hospitals might be substantially similar to a worker who sells car parts to auto body shops.[196] Both workers function as salesmen, regardless of the product being sold.

Moreover, the similarity of the workers' job functions must be subordinated to similarity in control factors because the important consideration turns less on the final outcome of the workers' products and more on their right to control the means of completion. Thus, two workers in different industries, such as a janitor and a landscaper, might be substantially similar if they both have comparable abilities to set their own hours, hire assistance, and work for others.[197] Likewise, two telemarketers placing identical phone calls might not be substantially similar if one works flexible hours from home while the other works at the company headquarters under a set schedule.

iii. Access to Resources

The third functional factor, access to resources, probes the source of the tools and instrumentalities used by the workers to perform their

195 *See* Lowen Corp. v. United States, 785 F. Supp. 913, 916 (D. Kan. 1992) (finding that two workers were substantially similar, in part, because they reported to the same supervisor).

196 See *id.* at 915–16 (finding a decal salesperson to be substantially similar to a sign salesperson).

197 *See* Lambert's Nursery & Landscaping, Inc. v. United States, 894 F.2d 154, 156–57 (5th Cir. 1990).

job functions. In conducting this inquiry, courts must examine whether the workers' resources, including office supplies, vehicles, and other equipment, come from the same source. If a company requires its employees to use employer-provided resources, and the misclassified worker supplies her own tools, courts should be less likely to find substantial similarity between the workers.

iv. Compensation

In assessing the final control factor, courts should compare levels of compensation rather than compensation structure, which will be discussed below.[198] Courts must be careful when investigating the pay difference between two workers because the disparity may be caused by factors other than classification, such as skill and experience. To illustrate, an independent contractor receiving higher hourly wages than an employee might not appear substantially similar to the employee. If the pay difference can be attributed to the independent contractor's higher level of skill and experience rather than her forfeiture of plan benefits, however, then it does not offer much insight into the substantially similar inquiry.

Courts, therefore, must discount variables such as skill and experience when comparing the salary levels of two workers. Because this subjective valuation is difficult to perform, courts should weigh the compensation factor significantly less than all other functional factors. This Note recommends that courts seriously entertain pay differences only where the record clearly demonstrates that the employee received adequate compensation in exchange for lost benefits.

c. De Mimimis Factors

In addition to functional similarities and differences, courts should note, but should not overly emphasize, de minimis factors. De minimis factors, which do not affect the essential nature of the work relationship, include uniform and dress, the right to attend company events, and job title. Functional factors, especially those with respect to control and job function, should almost always trump de minimis factors.

In the absence of functional factors, however, de minimis factors determine the outcome. In such a situation, courts must assign more weight to de minimis factors that bear more directly on an individual's ability to control the manner in which she performs her work. Thus,

198 *See infra* Part IV.C.1.d.

the fact that two workers abide by the same uniform policy, which constrains their ability to control their workplace appearance, weighs more heavily than the fact that they are not invited to the same company functions.

d. Artificial Factors

Courts should wholly discount artificial factors, which result solely from the misclassification itself. Employers create artificial differences by giving workers a Form 1099 rather than a Form W-2 or providing different compensation structures for independent contractors and employees. Employers, for example, could pay independent contractors hourly wages rather than a salary or could pay independent contractors through the accounts-payable department rather than payroll. Because the employer's bad faith actions create these differences, courts should disregard them when conducting the substantially similar inquiry.

2. Proving Knowledge: Illustrations

To illustrate how courts should apply the factors to a factual milieu, consider the following scenarios.

a. Scenario 1: Knowledge Not Proved

Worker *A* and Worker *B* both deliver packages for Letter of the Law, a task they must complete by a specific deadline. Worker *A* is required to drive a company truck, use company hand trucks to wheel packages, wear a company uniform, and deliver packages between 9:00 a.m. and 5:00 p.m. Furthermore, when she gets sick, she must call a company-approved substitute driver to complete her route. Worker *B* also drives the company truck, uses company hand trucks, and wears the company uniform. Unlike Worker *A*, however, Worker *B* sets her own schedule and hires outside assistance when necessary to complete her route. Additionally, Worker *B* is allowed, using her own vehicle, to make deliveries for other companies during the work week.

In this scenario, three factors cut in favor of finding substantial similarity between the two workers: they have the same job responsibilities (functional—job function), use the same company resources (functional—resources), and wear the same uniform (de minimis). Three factors, however, cut against finding substantial similarity: they have different abilities to set their own schedule (functional—control), hire outside assistance (functional—control), and work for others (functional—control). Here, the control-factor differences trump the similarities. Thus, Worker *A* is not substantially similar to Worker *B*, and, in a section 502(a)(1)(C) action based on these facts, a plaintiff would not be able to demonstrate a knowing misclassification.

b. Scenario 2: Knowledge Proved

Worker *A* and Worker *B* both deliver packages within a specified timeline, but now work for Cutting Corners. Worker *A* must drive the company truck, wear a company uniform, work from 9:00 a.m. to 5:00 p.m., and call preapproved company substitutes in the event of sickness. Worker *B* works identical hours as Worker *A* and must devote her time to Cutting Corners during those hours. Moreover, Cutting Corners similarly bars Worker *B* from hiring outside assistance to allocate her job responsibilities. Unlike Worker *A*, however, Worker *B* drives her own truck, does not wear a company uniform, submits her hours to accounts payable, and receives a higher hourly wage than Worker *A*.

Here the similarities are based on two functional control factors: the workers share schedules and the inability to hire outside assistance. The differences run the gamut, but: (1) Worker *B* being paid through accounts payable must be ignored (artificial); (2) Worker *A* wearing a uniform should not be afforded much weight (de minimis); and (3) Worker *B* driving her own truck (functional—resources), although seemingly important, is discounted by her inability to use it to make deliveries for other companies between 9:00 a.m. and 5:00 p.m. (functional—control). One important difference between Worker *A* and Worker *B* is their level of compensation, but this difference must be subordinated to the functional control factors shared by the workers. Accordingly, courts should find that these workers hold substantially similar positions.

Suppose Worker *B* represents the plaintiff in an ERISA section 502(a)(1)(C) action, and Worker *A* represents an employee covered under the defendant's benefit plan. Here, the plaintiff would be able to prove, through circumstantial evidence, that the defendant knowingly misclassified her as an independent contractor.

3. Employer Defenses

Under the proposed amendment, the employer could escape liability by proving that it relied on a prior IRS determination that the worker, or an individual holding a substantially similar position as the worker, was an independent contractor for employment tax purposes.

Because the employer must analyze the IRS control test to classify its workers, an IRS decision should effectively defend the employer against charges of knowing misclassification. On the whole, this Note's proposed amendment provides plaintiffs an opportunity to prove knowing misclassification through circumstantial evidence, yet also affords employers an affirmative defense when they rely on authoritative sources to make classifications. The next Section applies the amendment to the *Microsoft* fact pattern.

D. *Application to* Microsoft

In *Microsoft*, the Ninth Circuit explicitly refused to probe the company's intent, adopting a standard that invalidates an ICA regardless of an employer's underlying motive or knowledge.[199] In doing so, the court set an alarming precedent, one that wholly disregards employer freedom and discourages the formation of employee benefit plans. By following the proposed amendment, the court could have held the company liable without adopting such an extreme standard. The facts on the record indicate that Microsoft knowingly misclassified the plaintiffs, resulting in their loss of plan benefits.[200]

Under the substantially similar test, the plaintiffs most likely could have established a knowing misclassification. The Ninth Circuit detailed many functional-control-factor similarities between the plaintiffs and Microsoft's employees: they shared the same supervisors, they both worked onsite, they worked the same core hours, and they worked on teams alongside one another.[201] Additionally, they performed identical functions (functional—job function).[202]

The dissent recognized one key functional difference between the workers: the difference in their hourly salaries (functional—compensation).[203] In the absence of evidence that the pay increase fully compensated for lost benefits, however, this factor is not enough to tip the balance in favor of Microsoft. Other differences cited by the dissent, including different email addresses (de minimis), different color ID badges (de minimis), and different rights to attend company events (de minimis), are inconsequential.[204] Moreover, the plaintiffs being

199 *See* Vizcaino v. Microsoft Corp., 120 F.3d 1006, 1010–11 (9th Cir. 1997) (en banc).

200 *See id.*

201 *Id.* at 1008.

202 *Id.*

203 *Id.* at 1019 (O'Scannlain, J., dissenting).

204 *Id.*

paid through accounts payable instead of payroll is an artificial difference that must be discounted.[205]

On balance, weighing the similarities and differences between Microsoft's employees and the plaintiffs suggests that the company knowingly misclassified its workers. Furthermore, Microsoft could not have asserted an affirmative defense. Nothing in the record indicated that the company relied on an IRS determination when classifying its workers. The IRS, in fact, reclassified the workers as employees during an audit conducted prior to the litigation.[206] Lacking an affirmative defense, Microsoft would most likely have been liable for knowing misclassification under the proposed amendment and would have been required to recompense the plaintiffs for lost benefits.

As illustrated by the *Microsoft* case, the knowledge-based standard proposed by this Note produces the best result: the standard targets bad faith employers, requiring them to indemnify misclassified workers. Detractors, however, might argue that this approach fails to remedy the misclassification problem, a criticism the next Section addresses.

E. Is This Enough?

One might argue that the remedy available under the amendment, compensation for lost benefits, does not adequately address the problem of misclassification because it fails to deter bad faith employers. If caught, the amendment requires these employers to do what they should have done in the first place: provide employee benefits. Indeed, more could be done to discourage abusive behavior. This Note, however, focuses upon finding a remedy that complements ERISA's statutory framework. As the law currently stands, ERISA's enforcement scheme does not award individuals monetary damages beyond lost benefits.[207] Although many have argued that ERISA relief should be expanded,[208] this debate goes beyond the scope of this Note.

Moreover, the relief provided by this Note's proposal adequately remedies the problem of misclassification in the employee benefits context. Misclassification is an issue that cuts across multiple sectors

205 *Id.*

206 *Id.* at 1008.

207 *See* Great-West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 209–10, 221 (2002); Mertens v. Hewitt Assocs., 508 U.S. 248, 255–60 (1993).

208 *E.g.*, Secunda, *supra* note 171, at 167.

of society. In almost every other context, governmental actors, including the IRS and many states, have launched concerted efforts to curb the abuse.[209]

Although these undertakings represent an important step toward remedying the problem, they cannot regulate private pension plans, an area under ERISA's exclusive purview. This proposal plugs the gap left by ERISA preemption, recognizing that the global problem of misclassification can be attacked in other arenas. In the pension arena, however, the remedy (compensation for lost benefits) should match the harm (deprivation of benefits); the proposal thus crafts a solution that aligns with the legislative intent of Congress.

Conclusion

Congress passed ERISA in 1974 to strike a delicate balance between competing interests in the employee benefits domain. Misclassification, as well as the federal judiciary's response to the problem, threatens the balance between employee protection and employer freedom achieved by the statute. To harmonize ERISA's dual policy goals, Congress should enact an amendment specifically targeting abusive behavior. Under this standard, courts would give deference to employers acting in good faith, while holding bad faith employers liable for making knowing misclassifications. Ultimately, a knowledge-based standard best addresses the problem of misclassification in the employee benefits context: it protects employees from abuse, yet also incentivizes the expansion of benefits by allowing employers to retain a measure of discretion over their plans. Hence, it artfully balances the ERISA seesaw.

---

209 *See supra* notes 9–10, 41–44 and accompanying text.