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BUSINESS

Bosses Reclassify Workers to Cut Costs

Scrutiny into relationships with contractors leads to new strategies

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Harjinder Dubb of Norwalk, Calif., drove a SuperShuttle from 2003 to 2008 and says he was labeled an independent contractor. PHOTO: JONATHAN HANSON FOR THE WALL STREET JOURNAL

By **LAUREN WEBER**

June 30, 2015 5:36 p.m. ET

 66 COMMENTS

As courts and regulators increase their scrutiny of the relationship between businesses and independent contractors, employers are turning to a range of tactics to classify workers, taking them off the formal payroll and lowering costs.

Employers have long shifted work from employees to independent contractors, often relabeling the workers and slightly altering the conditions of their work, court documents and settlements indicate. Now, businesses are turning to other kinds of employment relationships, such as setting up workers as franchisees or owners of limited liability companies, which helps to shield businesses from tax and labor statutes.

In response, some state and federal agencies are aggressively clamping down on such arrangements, passing local legislation, filing briefs in workers' own lawsuits, and closely tracking the spread of what they see as questionable employment models.

All this is happening against the backdrop of a broader shifting of risk from employers to workers, who shoulder an increasing share of responsibility for everything from health-insurance premiums to retirement income to job security. Alleged misclassification of workers has been one of the primary battlegrounds of this shift, leading to high-profile lawsuits against Uber Technologies Inc. and FedEx Corp., among others. Both have recently lost or settled big cases. Uber is appealing one decision, and FedEx settled in California for \$228 million but is continuing to challenge classification lawsuits in other states.

"We're seeing more creative ways to misclassify workers," Patricia Smith, chief litigator at the U.S. Labor Department, said at a legal conference in the spring, referring to a recent victory by the agency over construction companies in Arizona and Utah using phony LLCs.



Former SuperShuttle driver Harjinder Dubb. Drivers for SuperShuttle purchase their own vans. PHOTO: JONATHAN HANSON FOR THE WALL STREET JOURNAL

“LLCs are generally small businesses that are trying to get back to business and are facing an increasingly difficult time because of this kind of enforcement,” said Jerry Howard, chief executive of the National Association of Home Builders. “We educate our members on a very regular basis and teach them how to comply” with labor statutes, he added. He declined to comment on the findings of the Arizona and Utah investigation.

In that investigation, the department and its state counterparts found that more than 1,000 construction workers were building houses as employees one day and then a day later had begun performing the same work on the same job sites as so-called owners of LLCs, but without any wage or safety protection. In April, the construction firms that had put the plan in place—and had avoided paying hundreds of thousands of dollars in payroll taxes—were ordered to pay \$700,000 in back wages, damages and penalties.

In the coming days, David Weil, the administrator of the Labor Department's Wage and Hour Division, is expected to release a detailed memo on worker classification, the first such guidance since President [Barack Obama](#) took office.

A particular focus for Mr. Weil and for plaintiffs' lawyers is brands that sell franchises not to a traditional small-business owner—say, a person who owns six outlets of a national fast-food chain and hires dozens of employees—but to low-wage workers such as janitors and delivery drivers who essentially pay franchise fees in exchange for work.

“There are a lot of legitimate franchise forms,” but companies that abuse the franchise model deny workers access to overtime and minimum-wage pay requirements as well as health and safety protections, and they lower the standards at rival firms, which can't compete unless they follow the lead of unscrupulous firms, Mr. Weil said in an interview. “They can undermine responsible employers and take root in an industry,” he added.

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In 2012, Maria Jacobo sold many of her personal belongings to buy a franchise from CleanNet USA, a janitorial service. In exchange for paying the \$10,000 franchise fee, she said she was told she would receive accounts valued at several thousand dollars a month to clean offices and other commercial buildings. Ms. Jacobo had been a solo housecleaner before she seized the opportunity to become a small-business owner through CleanNet, according to court documents.

But last year, Ms. Jacobo joined a lawsuit against the company, charging that it controls all aspects of the cleaners' work, including their fees and communications with clients, making them essentially employees of the firm even as it uses the franchise model to avoid the obligations of an employer, such as minimum-wage and overtime payments.

Janitorial services were among the first to use the franchise model to designate individual workers, often low-skilled immigrants, as independent owners. CleanNet alone has faced claims from workers in California, Maryland, Texas, Pennsylvania and Illinois in the past two years. Those claims are in settlement discussions or have moved to arbitration due to a clause in the company's contracts. Another franchise cleaning service, Coverall North America Inc., agreed to pay \$5.5 million and stop operating in Massachusetts as part of a pending settlement with franchisees there and has faced other franchisee lawsuits in at least two other states. A case in Tennessee was settled in 2007, and a case in California in 2014. Ms. Jacobo's case is currently in arbitration; she declined to comment.

“CleanNet has no reason to believe that its California franchisees are misclassified,” said its outside general counsel, Benjamin Hahn, who added that aside from Massachusetts, states have upheld the janitorial franchise model. Norman Leon, an attorney with DLA Piper who has represented Coverall and whose firm is general counsel to the International Franchise Association, said, “The premise that some of the smaller janitorial companies abuse the franchise model or that all of those franchises are operated as sole proprietorships—both of those assertions are incorrect.”

The model isn't limited to cleaning companies. Last year, SuperShuttle agreed to pay \$12 million to drivers in California who had argued that they weren't true franchisees—independent owners operating businesses and controlling their own destinies—but in practice were employees who should be reimbursed for business expenses like fuel and maintenance and paid for the overtime

hours they worked.

Harjinder Dubb drove for SuperShuttle from 2003 to 2008 and says he was labeled an independent contractor. He quit after SuperShuttle tried to convert him to a franchisee, which would have required him to pay fees to “rent” the SuperShuttle brand—essentially paying to do the same work he had done before.

As part of the settlement, SuperShuttle maintained its franchise model but changed its contract terms to reduce its control over drivers and give them more opportunities to earn other income with their vans, which the drivers purchase themselves for as much as \$35,000. SuperShuttle had settled similar suits in Minnesota, New York and Florida, but the California settlement is the largest to date.

“We felt it was in our best interest to settle the case because we wanted to move on with running our business,” said Tom Lavoy, deputy chief operating officer of SuperShuttle’s parent, Transdev On Demand. He added that the franchise system has reduced turnover and improved safety among drivers. “We still believe it’s the right model because independent business owners are more efficient than what we can generate from an employee business,” he said.

Write to Lauren Weber at lauren.weber@wsj.com

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This scenario would never exist...

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We will see many more part-timers working 29 hours a week max.

Obama's America = part-time jobs + no benefits.

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@james doppelheuer There are simply too many Americans not being cheated by employers for Jmmy's taste...

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James Doppelheuer

@Anthony Zipple

The employer/employee relationship is still a voluntary one.

The daft, like Anthony, need Big Brutha to coddle them.

5 minutes ago



DAN OAKS

Sadly, it is the method companies and supervisors use to "pretend to value good employees whom are willing to do the extra work" that companies enjoy but would rather not pay for. It is most common among direct customer service employees with banks and retailers who are dedicated employees looking for an opportunity to establish careers. Teachers and educators are another perfect example.

It is a complete shame for the vast majority of employees who are salaried.

16 minutes ago



James Doppelheuer

@DAN OAKS

Democrats murdered "shame" back in the 60s and 70s.

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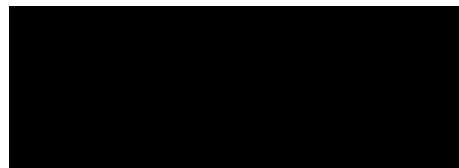
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