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Classifying appraisers as independent contractors is a hot issue that sends chills through the valuation profession

Independent minded

by Peter T. Christensen

The misclassification of workers as independent contractors is a hot issue, one that's attracted government attention as agencies grapple with regulating so-called gig economy companies, such as Uber and TaskRabbit. The issue also has caught the attention of the legal community, with plaintiffs' lawyers filing suit against unprepared employers. It should grab the attention of valuation firms as well, as they often classify appraisers as independent contractors.

Many valuation firm owners and managers already are familiar with this contentious issue, so I'll offer my conclusion straightaway to soothe some fears: Smaller valuation firms that treat their non-owner appraisers as contractors generally have been able to avoid serious consequences

when they follow the rules and understand relevant factors. Bigger valuation firms, however, may have more to worry about.

Let's review a scary but true story about misclassification from a "big management company."

The case went to trial in California, and while it offers key takeaways for all valuation firms on classification issues, it may be a harbinger for appraisal management companies in particular.

Instead of using the defendant company's name, I'll refer to it as "BMC" — short for big management company. BMC's business is "vendor management," and it maintains a nationwide panel of several thousand vendors who perform services for lender clients and loan servicers. In 2013, one of BMC's California ven-

dors filed suit against it on behalf of himself and an alleged class of hundreds of other vendors on its panel in that state.

The plaintiff contended that he and other vendors effectively were employees rather than independent contractors, and as such, BMC was liable to them for unpaid overtime and unpaid business expenses. A true employer would legally be responsible for overtime under federal and state law and be responsible for employee-incurred expenses under state law.

Plaintiff's counsel set out to prove that BMC vendors should be classified as employees rather than as contractors by introducing evidence that showed BMC "tells vendors where to go, when to go, what to do, when to get it done and how much and when they will be paid for their efforts." The evidence showed the following:

- Vendors applying to be part of BMC's panel were required to sign an agreement that referred to them as independent contractors, but then put forth detailed requirements for accepting assignments, scheduling property access, performing work in a timely manner, taking and submitting photos, updating status and meeting quality standards.
- Vendors were not provided meaningful opportunity to negotiate the agreement.
- Vendors were required to authorize BMC to perform background checks.
- BMC offered assignments to vendors through its proprietary software platform, and vendors were required to use the platform to upload their status reports, photos and invoices.
- Vendors were required to respond to assignment requests within 24 hours and complete assignments within a specific time frame — sometimes just three days.
- Vendors who declined too many assignments or cherry-picked the best ones could be offered fewer assignments.
- BMC "score-carded" vendors on accept/decline assignment rates, communication status, completion times and quality. A low rating could result in a warning, reduction in work or ineligibility.
- BMC tracked vendor performance and recorded warnings, counseling and suspension eligibility in "vendor profiles."

At trial, vendors testified that they worked long hours — often 10 hours per day, six days a week — but received no overtime because BMC classified them as independent contractors. They also were not reimbursed for expenses, including mileage, insurance, equipment, cellphones, computers or internet access.

What happened? After four years of litigation, the court ruled on summary judgment that vendors who derived more than 70 percent of their income from BMC should be classified as employees and therefore are entitled to overtime and expense reimbursement. The court reasoned that the contractors were employees under California law because BMC had the right to closely control its contractors' work (and exercised that right) and because contractors were so dependent on BMC.

With liability established, attention turned to the amount BMC owed its reclassified contractors. A jury last summer awarded the named



plaintiff and 10 class-action members a total of \$2,060,237 for unpaid overtime, unpaid expenses, penalties and interest. The jury determined that the named plaintiff worked 4,845 hours of overtime between 2010 and 2016 and therefore should recover \$98,615 in overtime payments (on top of the payments he received for doing the work). They also determined that he should be awarded \$168,746 for unpaid expenses (\$95,247 for mileage alone). It's estimated that there are 150 to 200 remaining class

State exemptions

States that specifically exempt appraisers from being classified as employees are few and far between, but include:

- New Hampshire (NH Rev. Stat. §281-A:2 exempts appraisers from treatment as employees for workers' compensation).
- Rhode Island (Gen. Laws 1956, §28-29-7.1 provides an exemption for workers' compensation subject to specific requirements).
- Virginia (VA Code Ann. §60.2-212 and §65.2-101 provide exemptions for workers' compensation and unemployment).

members potentially entitled to the same types of damages, and that BMC could be liable to its vendors on its California panel for as much as \$20 million more.

This case sounds like a lawsuit against an AMC, right? It wasn't. The defendant's business provides property preservation services to lenders and servicers on foreclosed properties. The case is *Bowerman v. Field Asset Services, LLC* (U.S. District Court, N.D. Cal., 2013). It not only highlights the dangers that all firms could face when they exert too much control over contractors' work, but because of the obvious similarities between the defendant's business and AMCs, it also suggests that many AMCs should re-evaluate some of their regular practices.

Why appraisers are classified as contractors

There are many compelling reasons for firms to classify appraisers as independent contractors:

- Independent contractors are not paid overtime for working more than eight hours per day or 40 hours per week, nor are they entitled to minimum wage.
- Firms do not withhold taxes or make Social Security and Medicare contributions for contractors, and need only report payments on an annual 1099.
- Firms generally do not pay unemployment or workers' compensation premiums for contractors.
- Contractors do not factor into the count for the Affordable Care Act, which requires firms to provide health insurance when there are 50 or more full-time employees.
- Contractors can be hired and fired more easily, and it can be difficult for them to pursue discrimination claims.
- If contractors are sued for professional negligence, their firms may not have any legal obligation to pay their legal bills.

Appraisers themselves see some benefits to being classified as independent contractors. Many enjoy being their own boss, and they can take advantage of tax benefits that allow them to deduct business-related expenses they otherwise wouldn't be able to as employees.

Properly classifying appraisers as contractors

Bowerman v. Field Asset Services revealed significant legal risk for improperly classifying employees as contractors — liability for unpaid overtime, unpaid employee expenses, penalties and interest. An employer also can face potential liability to state agencies for unpaid unemployment and workers' compensation costs, and to the IRS for unpaid employment taxes and Social Security contributions. Because the risks are big and the applicable tests can be complicated, all firms that classify appraisers as independent contractors are advised to seek knowledgeable, local legal counsel to discuss how to properly handle contractor arrangements within the framework of their own state laws, some of which specifically exempt appraisers from being classified as employees. (See "State Exemptions," left.)

Let's look more closely at the issue of employee classification at appraisal firms (not AMCs), where permanent staff members perform appraisals that go out under the firm's name. Not surprisingly, it's difficult to say whether a firm has correctly classified appraisers as contractors because there's no single test for making that determination. There are differences between federal and state laws, and the tests also vary depending on the purpose of the classification — whether it is for taxation, overtime, unemployment insurance, workers' compensation or liability. However, one element that is common to most tests is the firm's control over the worker.

The IRS, which applies what it refers to as the "common law" test, emphasizes the issue of control in its wage-withholding regulations, stating that a worker generally is considered an employee if:

The person for whom services are performed [the appraisal firm] has the right to control and direct the individual who performs the services [the appraiser], not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what

shall be done but how it shall be done. [Treas. Reg. §31.3401(c)-1(b) (annotations added in brackets).]

Additional factors to consider:

- Does the firm train the appraiser how to perform his or her work?
- Is the appraiser required to be present on the firm's premises?
- Is the appraiser required to work certain hours or days?
- Is the appraiser basically required to allot his or her full time to the firm?
- Does the firm pay for the appraiser's "tools," e.g., computer, appraisal software, MLS, Disto devices?
- Is the appraiser paid by the hour or the week (as opposed to by the project)?
- Is the appraiser permitted to accept and be paid for work independent of the firm, and does the appraiser take on independent work?
- Are other appraisers in the firm (other than the firm's owners) treated as employees?
- Can the appraiser realize a profit or suffer a loss because of his or her services for the firm?
- Does either party believe an employment relationship exists?

If any of these factors are a strong "yes," or if there are multiple "yes" answers, a firm would be wise to reconsider its classification of appraisers as contractors.

Creating a more defensible independent contractor relationship

For small and medium-sized valuation firms, the liability risk for misclassification has been relatively low — but the consequences very high.

Many firms properly structure their contractor arrangements to minimize potential problems, and even when they don't get all the details right, the risk of actual enforcement — or "getting caught" — is low. I've had many firms tell me, "We've been doing it this way for 20 years and never had a problem." The genesis of many state audits and class-action reclassification lawsuits often is a single independent contractor who has filed unsuccessfully for unemployment or disability benefits. The bigger the firm, the more likely this scenario and the greater the chance the

firm will be considered a profitable target for a multi-plaintiff lawsuit.

To decrease the risk of misclassification, firms that treat appraisers as independent contractors should use a written contractor agreement that spells out the relationship and is signed by both parties. The agreement will almost never be the controlling factor in a test, but it can provide clarity for firms and appraisers.

Key points to include in an agreement:

- The independent contractor appraiser has the right and freedom to work the hours that he or she deems necessary to perform accepted projects, and the manner of performing appraisals is under the exclusive control of the appraiser.
- The appraiser will not be treated as an employee for state or federal tax purposes or for purposes of workers' compensation or unemployment insurance.
- The appraiser may perform appraisals on behalf of himself or herself or for other firms, and may market his or her services to others.
- The appraiser is responsible for his or her own work "tools," including computers, tablets, software and Disto devices.
- The appraiser is responsible for his or her own training and continuing education.

Practices that firms should avoid:

- Referring to contractor appraisers as "staff appraisers" online or in print, and listing appraisers without specifically stating that they are independent contractors.
- Requiring a contractor appraiser to sign a noncompete agreement or other agreement to perform services exclusively for the firm.
- Classifying some appraisers in the firm as employees and others as contractors, especially when they perform the same type of work.
- Treating an appraiser trainee as an independent contractor. A trainee is not an independent contractor because of the required supervision of his or her work.

Valuation firms that are prepared and diligent improve their odds of remaining unscathed through audits and even IRS litigation. ◀

About the Author



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