



DELAWARE

EMPLOYMENT LAW LETTER

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EMPLOYEE CLASSIFICATION

Once more into the breach (of contract), dear friends

by Lauren E. Moak

It is a well-settled principle of contract law that if a party breaches a contract, it may later have trouble enforcing the provisions of that contract in court. Applying that principle, a recent opinion issued by the Third U.S. Circuit Court of Appeals (which includes Delaware) indicates that an employer's misclassification of an employee as an independent contractor may result in a breach of contract, which can later prevent enforcement of the contract's noncompetition provisions.

What's in a name?

This case has its roots in a 2004 independent contractor agreement (ICA) between Joseph Figueroa and Precision Surgical, Inc., a medical equipment supplier. The agreement included several restrictive covenants, including nonsolicitation, confidentiality, and noncompetition provisions.

Figueroa worked for Precision from 2004 until September 2010. During that time, Precision began treating Figueroa as an employee rather than an independent contractor. Specifically, it required him to:

1. devote 100 percent of his time to selling products offered by Precision;
2. report to his supervisors daily and attend monthly meetings;
3. adhere to the company's dress code; and
4. obtain permission from Precision before giving quotes to certain prospective customers.

As Precision's supervision and reporting requirements became more onerous, Figueroa objected. He eventually requested a new ICA that would clarify his relationship with Precision and eliminate the burdensome oversight provisions. Precision refused, instead informing him that it wanted to eliminate all independent contractor positions. When Figueroa refused to become an employee, Precision terminated his ICA.

Figueroa filed a lawsuit seeking to invalidate the noncompete provisions in his agreement. Precision responded with a counterclaim seeking to prevent him from contracting with one of its competitors.

A rose by any other name would smell as sweet

To succeed on its counterclaim, Precision was required to demonstrate (1) a reasonable probability of success on the merits of its claim, (2) irreparable harm resulting from the denial of relief, (3) a balance of the equities favoring Precision, and (4) that relief would be in the public interest. Figueroa argued that Precision should be denied relief in the form of an injunction (*i.e.*, an order enforcing the agreement) because it wasn't likely to succeed on the merits of its claim. More specifically, he alleged that it had breached significant terms of the ICA and therefore was unlikely to succeed in its efforts to enforce the contract.

In the end, the Third Circuit denied the injunction sought by Precision on the grounds that it didn't have a reasonable probability of success on the merits of its breach-of-contract claim. Reviewing the evidence presented by both parties and paying particular attention to the requirements imposed on Figueroa by Precision, the court concluded that Precision had treated Figueroa like an employee instead of an independent contractor. As a result, it likely significantly breached the ICA. Thus, it was prevented from obtaining an injunction and will presumably face an uphill battle in future efforts to enforce the agreement's noncompete provisions. *Figueroa v. Precision Surgical, Inc.*

Bottom line

Most employers are aware — and all employers *should* be aware— that properly classifying workers as employees or independent contractors is critical for many reasons. However, you should now consider an additional consequence for misclassifying workers. Treating an independent contractor as an employee may result in a court's determination that you breached an ICA, rendering any restrictive covenants contained in the agreement unenforceable.

Based on the Third Circuit's holding, you should review your ICAs to ensure that the requirements imposed on independent contractors are consistent with the terms of their agreement. Failure to do so may leave you unprotected if an independent contractor later engages in competitive behavior.

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