

## How FedEx is trying to save the business model that saved it millions

By Lydia DePillis

**M**ornings start at the FedEx facility in Halethorpe, Md., with “The Sort.”

Sixteen thousand packages arrive from regional hubs in Pennsylvania, Maryland and Virginia, get sifted by Zip code, and trundle through the roller coaster ride of blue tubing that snakes through a giant warehouse. Finally, they are deposited next to the dock of a truck that’s supposed to deliver them to their destination.

Except sometimes, a box doesn’t show up — causing enormous frustration for the person in charge of delivering the package.

At 8:15 one morning last week, that was Vern Brumfield, a FedEx driver for three years, who found himself waiting for a missing package, two hours after he started work.

“When you’re missing something, it’s a nightmare, because you don’t know where to look,” says Brumfield, sitting on the back of his truck, gazing at a scanner listing one last tracking number he’s supposed to find. “They want you to find that box. I waste a good hour every day. If everything was here in the morning, I could load the truck in 15 minutes. Instead, I get here at 6 in the morning and leave at 9 o’clock.”

After leaving the warehouse, Brumfield works some days until late in the evening, delivering packages in Pasadena, a suburb of Annapolis. Brumfield, 58, says that’s a long day for what he gets paid — between \$30,000 and \$35,000 per year — with no overtime, no retirement plan, no health-care benefits and only one week of vacation per year. “FedEx Express and UPS drivers, they probably make twice what we’re making,” says Brumfield. “And we’re carrying the same thing they’re carrying.”

The difference, indeed, is significant: A full-time, unionized UPS driver starts at a base of \$39,000 a year, with regular raises up to \$52,000, overtime pay that brings the total to more than \$80,000 for a majority of drivers, a full benefits package, and significantly more protections against losing his job.

It may seem bizarre in a free-market economy that two people with nearly identical positions would receive starkly different pay and benefits. But it’s actually not such a mystery: Brumfield doesn’t actually work for FedEx. Brumfield, like 26 other drivers, works for Ride On Trucking, an independent business that contracts with FedEx to deliver packages. He has to comply with all the provisions Ride On Trucking agrees to with FedEx — such as passing a background check and delivering packages within a certain time window — but the company doesn’t offer the same wages or benefits that he thinks that FedEx pays its own drivers, who work for its overnight Express division. FedEx doesn’t disclose wage information, but Brumfield says he’s talked to Express drivers who make \$20 to \$30 an hour. He’s also applied to work at UPS and FedEx Express, to no avail.

The Ride On Trucking arrangement, known as the “independent service provider” model, represents FedEx’s creative effort to maintain control over its workers while avoiding the cost of employing them directly. It’s essentially a version of subcontracting, which has proliferated through industries from logistics to construction to manufacturing in today’s changing economy.

It’s another sign of the declining quality of the full-time, salaried job in America — fit for an age when temporary staffing agencies supply labor to run warehouses and package goods, Internet start-ups call themselves “platforms” for house cleaners and limo drivers to connect with customers, and airports outsource, cleaning and maintenance to the firm

with the lowest bid. The strategy has been a boon for business — and has even benefited many customers, by leading to lower costs — but it has also undermined unions and depressed wages.

Now, however, judges and regulators are starting to look more critically at these relationships. In the fast-food world, the National Labor Relations Board's general counsel has determined that some big companies share responsibility with their franchisees for labor violations. The Labor Department has been aggressively pursuing companies that it says misclassify employees as independent contractors — in 2008, current Labor Secretary Thomas Perez, who then a senior Maryland state official, testified that included 20 percent of Maryland businesses. The Labor Department recently awarded \$10.2 million to states to do the same.

In FedEx's case, courts in several states, including California and Massachusetts, have told the company that its strategy of treating drivers as independent contractors doesn't fly, prompting the shift to the independent service provider model. Now, at least one court has questioned whether even this new model passes muster.

“The ramifications are monstrous,” says Jeffrey Hirsch, a professor at the University of North Carolina law school who specializes in labor. “To me, it just looks like what a lot of other companies are doing, trying to classify people who are really their employees as independent contractors. FedEx is putting this sort of novel contract relationship between the two.”

The roots of Brumfield's discontent go back to 1985, when a company called Roadway Package Systems was founded as a competitor to UPS. It used independent contractors as a lower-cost, flexible workforce, which FedEx found attractive. Primarily an airline, FedEx wanted to get into the ground business, so it acquired RPS in 1998. By 2004, it had 16,200 owner-operators, who each took on a route and all the responsibilities of running their own business.

“We were the new kid on the block, on the ground,” says FedEx spokesman Perry Colosimo. “That was one of the ways to differentiate, to go out and find people who were going to work hard and build a business. These business owners have a way of

squeezing more productivity out of themselves. It makes their businesses more efficient, but obviously we benefit from that.”

Lou Milio, the owner of Ride On Trucking, is the kind of scrappy business owner FedEx has relied on. In 2003, Milio had lost his painting company and his house to a weak economy and a messy divorce. He was looking for a new gig to pay the bills when he saw an ad in the classifieds for a FedEx driver. He'd been self-employed since he was 19, so the idea of becoming an independent contractor again made sense.

“They told me I could own my own truck, make a wage, and I said, ‘I'll take it,’ ” recalls Milio, now 57. He bought a truck and joined the ranks of solo operators whom FedEx paid by the package, the mile, and the number of stops, no matter how long it took. At first, he didn't know the route through Annapolis's tight turns and cul-de-sacs, and sometimes wouldn't finish until late at night.

“I wasn't making a penny my first year, because I couldn't take the stops out,” says Milio, using the truckers' lingo for delivering to a certain number of locations. Milio, imposing and jowly and with an ever-present Bluetooth earpiece that seems it had sprouted from his head, says he learned soon enough. “I ended up being the best that ever delivered to Annapolis. And then I said, ‘How far can I go?’ ”

By the late 2000s, though, FedEx's independent contractor model was starting to fray. Established tax and labor law requires that workers have a degree of independence to be classified as independent contractors. There's no precise definition of what “independence” means, and it varies across states, but courts started ruling that FedEx's arrangements didn't fit the bill: Drivers had to wear the FedEx uniform and drive trucks with FedEx logos on the side, which practically prevented them from taking business from other companies that might want them to deliver goods. They had to live with a standard, non-negotiable contract that spelled out how the job was to be done, leaving drivers with little decision-making power of their own.

By 2005, lawsuits had been filed in dozens of states. Starting in 2007, drivers charging they had been misclassified as independent contractors won or

settled cases in California, Missouri, Maine, Massachusetts, Illinois, Montana and Oregon. FedEx sometimes won cases, arguing that it didn't strictly control how its contractors got the job done.

In 2009, facing this more difficult regulatory landscape, FedEx introduced a new model — contracting with independent businesses that covered larger service areas with multiple drivers. According to FedEx, this new arrangement — which is now required in 17 states, with four more in the works, including California — meets the legal test because individual providers can negotiate over the details of the working arrangement with FedEx managers. The provider can bargain over compensation rates and service areas, for example, and decide whether his drivers wear FedEx uniforms (the company pays him a fee if they do).

“Now, you go to the table and say, ‘This is the truck I have, this is the deliveries I make, this is how much I need,’ ” explains Milio. “And they say yea, nay, and you go back and forth.”

After the introduction of the new model, many drivers left the industry, but Milio thrived, buying up enough routes to stay in business, and then adding more until he became the biggest in the area. Now he has 27 routes and lives in a sprawling house on the Chesapeake with two Jet Skis parked outside in a trailer. He lives with girlfriend Lois James, a former independent contractor who sold him her route and became an employee. She now manages most of the day-to-day business, since Milio has a seventh-grade education and never learned to write.

“Everybody at the beginning stages of this was so negative. And I never understood that,” Milio says. “I see it just the opposite, as an opportunity.”

Milio says he knows that his drivers want more from their jobs. As employees, they are entitled to protections such as workers compensation and unemployment insurance. Unlike many providers, Milio offers a base salary — he declines to say how much — and says drivers can earn additional wages by making more than 150 stops per day. He tries to motivate them by offering Driver of the Month bonuses and an annual banquet for Driver of the Year, along with tales of his rise from the Baltimore projects to being a successful entrepreneur.

“The incentive is, if I want this lifestyle, I've got to do more. If your truck breaks down, do you finish your route?” Milio says, who often fills in on routes himself if someone doesn't show up for work. “Do you have the incentive, when you feel sick, to come to work? The ones that just can't seem to get it, can't accept the challenge.”

Many of Milio's drivers say that they value the job they have, and even enjoy it — but they often have far less ambitious expectations about where it can lead.

“I'm going paycheck to paycheck,” says Matthew Gary, 36, who's been driving for Milio for eight years. He says he averages about \$37,000 per year, which is barely enough to cover expenses. He'd like to get a second job, but not knowing when you'll be able to leave work — if traffic's bad, or a package gets lost — makes it difficult. “I'm not making enough right now, but by the time I get home, I'm beat.”

Gary has also checked in with a few of the seven other providers in the Halethorpe facility to see whether they offer any better pay. He could move if he wanted to, but Milio says he's tried to prevent drivers from jumping around too quickly by working out a “gentleman's agreement” with other ISPs to not steal drivers with less than a two-week notice.

“Just imagine, five of my guys could leave some day because somebody had decided to pay 'em more,” Milio explains. “Would it be fair for me to have five routes that couldn't run because they decided to go to this contractor? It would create a bidding war, and all of us would go out.”

FedEx says it has little control over these arrangements, because Milio isn't officially an employee. “We don't have anything to do with that,” spokesman Colosimo says.

The independent service provider model worked well for FedEx, which has been posting record profits lately. But it's also increasingly running into roadblocks.

In early October, the Kansas Supreme Court ruled that FedEx's contractors, even when they employ drivers for other routes, are effectively FedEx employees themselves — which means their employees may be, too. “I think FedEx was just

dealt a body blow by the Kansas Supreme Court,” says Richard Reibstein of Pepper Hamilton, who specializes in independent contracting. “Basically the court is saying that ‘the argument that you’re an independent business when you have more than one route, we don’t buy it.’ And that was a surprise.”

FedEx says it disagrees with the court’s reasoning, because its contracts allow for freedom and flexibility in operations, and will appeal the decision.

But if the verdict stands, and other courts agree, FedEx may ultimately have to consider other structures — including, potentially, making its drivers full employees. That would make them much easier to unionize, which could lead to higher labor costs and less flexibility down the road — like at FedEx’s major competitor, UPS.

Labor leaders say the model benefits UPS. “They have lower turnover cost and more productive workers that enjoy higher wages and benefits,” said Iain Gold, director of strategic research and campaigns for the International Brotherhood of

Teamsters, which represents UPS drivers and has long campaigned to represent FedEx drivers as well.

In addition, Gold notes, UPS has the efficiency of a more integrated company, which it says allows it to pay drivers more. FedEx has to keep its delivery services separate, because some divisions fall under less union-friendly labor laws, which leads to some redundancy.

Nevertheless, FedEx thinks staying union-free is worth more in the long run and has gone to great lengths to preserve its segmented business model — including, most recently, vehemently defending its right to subcontract out ground delivery.

That’s fine with Milio, who’s made it work to his advantage.

“Where do I live? Where do I go? Where do I eat? Always earned, never given, is what I teach my drivers,” he says. “The more you do, the more you get paid. There’s no better free-enterprise concept on this planet. This country says, if you want to achieve, we’ll give it to you.”