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Management Alert

DOL Issues Guidance On Independent Contractor Classification Interpreting FLSA Broadly to Cover Most Workers as Employees

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Today, the U.S. Department of Labor's Wage and Hour Division (WHD) issued its first Administrator's Interpretation (AI) on the Fair Labor Standards Act in more than a year. As the Administrator, Dr. David Weil, had forecast in a speech last month, today's AI discusses the important topic of independent contractor and employee classification under the FLSA. The AI is an unapologetic effort to restrict the use of independent contractors: "[M]ost workers," the Administrator concludes, "are employees under the FLSA's broad definitions."

As background, an AI is an agency interpretation, and is not subject to the notice and comment process required for rulemaking, such as the Department of Labor's proposal to amend the "white collar" exemption regulations published last week. (See guidance on *Retail*, *Hospitality*, *Financial Services*, and *Healthcare*.) The extent to which courts should defer to the AI, if at all, is likely to be the subject of debate and litigation. It is clear, however, that the AI does not have the force of a regulation properly issued after notice and comment. The AI does not announce a new test for employee, as opposed to independent contractor, status. Rather, it grafts the multi-factor "economic realities" test that courts commonly use onto an extremely expansive reading of the FLSA's "suffer or permit to work" definition of "employ." In so doing, the Administrator's analysis and examples further WHD's recent efforts to investigate the use of independent contractors. Combined, WHD's efforts indicate a significant hostility towards the use of independent contractors.

The result that the Administrator seeks is to severely restrict the use of independent contractors and to require businesses to reclassify those workers as employees subject to the minimum wage and overtime requirements of the FLSA as well as to other federal and state laws applicable to the employment relationship. The Administrator also notes that the same analysis of independent contractor v. employee status under the FLSA applies to the FMLA and the Migrant and Seasonal Agricultural Worker Protection Act.

The Administrator's Interpretation relies on the "economic realities" test to assess whether an entity "suffers or permits to work" individuals who are entitled to the FLSA's statutory protections. At the highest level, the AI states this test as "whether the worker is really in business for him or herself (and thus is an independent contractor) or "is economically dependent [on the business for which he or she provides services] (and thus is its employee)."

In the AI, WHD continues its use of six factors typically included in an analysis of the "economic realities" test, and restates its belief that no one factor is controlling or should be given "undue weight." And, additional factors relevant to any particular situation may also be considered. The key is to determine whether workers have sufficient economic independence by operating a business of their own. These six factors include:

1) The extent to which the work performed is integral to the employer's business;

2) Whether the worker's managerial skills affect his/her opportunity for profit and loss;

3) The relative investments in facilities/equipment by worker and the employer;

4) The worker's skill and initiative;

5) The permanency of the worker's relationship with the employer; and

6) The nature and degree of control exercised by the employer.

Starting from the premise that "most workers are employees under the FLSA's broad definition," WHD rejects the parties' understanding of their relationship, as well as whether they have an agreement regarding the nature of their relationship. As the AI states: "[A]n agreement between an employer and a worker designating or labeling the worker as an independent contractor is not indicative of the economic realities of the working relationship and is not relevant to the analysis of the worker's status." (emphasis supplied).

Instead, today's AI reviews and considers each of these factors -- emphasizing the extent to which the services at issue are integrated into the business of the entity receiving them and deemphasizing whether the business has control over the service provider. Rather than simply restating the factors, however, WHD cherry-picks court decisions to support its position, ultimately concluding that the most important question is whether an individual runs a "truly independent business."

Here are the key points made by WHD regarding each factor of the test:

Integral To Business:

- Although the AI notes that no one factor is controlling, this factor is described as "compelling," and appears to have a heightened importance in the analysis.
- Work can be found to be integral to a business "even if the work is just one component of the business and is performed by hundreds or thousands of other workers."
- How this factor applies will be especially important to the growing "on-demand" business model, which often involves an attempt to redefine the structure of an industry so that services that were once performed by employees are performed by independent service providers.

Potential For Profit/Loss:

- The guidance explicitly rejects the theory that a worker's ability to work fewer or more hours at their own discretion equates to an opportunity for profit or loss.
- An independent contractor's opportunity for loss appears to now be a requirement under the test: "it is important not to overlook whether there is an opportunity for loss, as a worker truly in business for him or herself faces the possibility of a loss."

Relative Investments:

- The "relative" investments between the worker and a business "matter" under the AI, and "the worker's investment must be significant in nature and magnitude relevant to the employer's investment…to indicate that the worker is an independent businessperson."

- This adds a quantitative analysis to the equation, but fails to provide an acceptable ratio - only that a worker's investment should not be "relatively minor"; WHD then proceeds to dismiss the investment of $35,000 to $40,000 by a worker as, essentially, an inconsequential amount.

Skill/Initiative Requirement:

- The DOL's guidance emphasizes a worker's "business skill, judgment, and initiative" and *not* his or her technical skills under this factor.
- This language seems to explicitly dismiss any consideration of a worker's technical ability and would focus the analysis solely on the worker's business acumen.

Permanency Of Relationship:

- The AI states that "the key is whether the lack of permanence…is due to the operational characteristics intrinsic to the industry."
- As an example, staffing agency workers were viewed as employees given the nature of the industry and the permanency in the working relationship.

Degree Of Control:

- The AI specifically de-emphasizes the importance of this factor and says it "should not play an oversized role in the analysis."
- A company's exercise of control due to the nature of their business, regulatory requirements, or their desire to maintain high customer satisfaction are not permissible reasons to exert control over independent contractors and still indicate an employee relationship.
- The fact that workers control the hours they work is "largely insignificant" where such freedom is typical in the worker's specific industry.

Taken collectively, these views -- supported by cases cited by WHD, but dismissing virtually all contrary authority -- represent an effort to expand dramatically the "economic realities" test. Coupled with WHD's proposed massive increase to the salary level required for the "white collar" exemptions -- published less than 10 days ago -- WHD's actions have the potential to fundamentally alter countless business models, without Congressional activity, without proposed language (in the case of the duties tests for the exemptions), and, in this case, without any opportunity for the regulated community to provide its comments on WHD's position.

Any business that uses independent contractors extensively or to receive services that are important to its success should review this AI and consider carefully how the WHD and courts applying the economic realities test would view its independent contractor relationships. A business that misclassifies an individual as an independent contractor may face significant exposure under the FLSA, including liability for any failure to pay at least the minimum wage for all time worked, failure to pay overtime for work in excess of 40 hours per week, violations of the Family and Medical Leave Act and other statutes that borrow the FLSA's definition of "employee," and violation of the FLSA's recordkeeping requirements. Failing the FLSA economic realities test may also indicate possible misclassification under other federal and state statutes, which may carry even greater exposure, including liability for failure to: reimburse employee expenses, provide various employee benefits, withhold income taxes and FICA, pay unemployment insurance contributions and provide workers compensation insurance coverage.

Lawsuits challenging workers' classifications under the FLSA have become common; plaintiffs' lawyers have challenged both individual classification decisions and new and old industry models involving independent contractors. The broad guidance issued by WHD today will likely be used by the plaintiffs' bar to try to chip away at independent contractor classifications. Businesses and management-side practitioners should take inventory of those decisions that have a more reasoned and

neutral application of the "economic realities" test and be prepared to use those cases -- and not those cited in the AI -- as a more appropriate view of the standard.

In addition, WHD has aggressively sought to enforce independent contractor standards through investigations and audits, which may ultimately give rise to lawsuits filed by the DOL. Indeed, WHD has requested budget increases for more than 300 new full-time enforcement positions, and has provided millions of dollars for worker misclassification detection and enforcement initiatives. On top of that, of course, are the back wages WHD has recovered for newly-determined employees. And as we've previously reported, the spike in "on demand" services available via smart phones has created a wave of independent contractor misclassification lawsuits that has greatly increased the visibility of this issue.

Taking the long view, Dr. Weil's guidance is also in keeping with the WHD's apparent goal of affecting widespread change in the manner in which U.S. businesses designate workers as independent contractors. Indeed, Dr. Weil has previously written that, "we need to create ripple effects that impact compliance far beyond workplaces where we physically conduct investigations, or organizations to which we provide outreach directly. We need to continue to find ways to make our investigations of one employer resonate throughout that particular sector and influence the behaviors of employers across the entire industry…"

Ultimately, the AI is consistent with the DOL's stated intent to aggressively challenge independent contractor classifications. The guidance now makes it likely that DOL investigations and enforcement actions and private litigation contesting the classification of such workers will intensify. Businesses should, therefore, carefully evaluate the DOL's guidance and its potential impact on their operations. We will continue to inform our clients and the broader employer community about the effect of the AI and to blog about these issues at *www.wagehourlitigation.com*.

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