

Management Alert



Energy Industry Insight: Federal Court In Houston Says Independent Contractor Misclassification Issue Must Go To The Jury

OVERVIEW

Some employers in the oil patch use “free-lance” welders and other craft workers. Do they qualify as “independent contractors” beyond the reach of the federal wage-hour law, thus freeing a company from paying overtime? A recent decision by Houston federal judge Keith Ellison required that the issue be decided by a jury, and denied the company’s summary judgment motion.

The decision points up the risks involved in classifying workers as independent contractors. The Department of Labor, IRS, and other government agencies, have sharpened their scrutiny of employers’ classification of workers as independent contractors. This can result in liability for minimum wage and overtime violations, as well as tax, unemployment, benefits, and workers’ compensation issues. This ruling should thus serve as an instant reminder for companies to review and audit the classification of their independent contractors.

BACKGROUND

The workers in *Trahan v. Honghua America, LLC*, No. H-11-2271, alleged they were misclassified and are owed thousands of dollars in unpaid overtime compensation. Honghua America, LLC—a company that builds oil and gas rigs and rig components for exploration around the world—argued that the workers were independent contractors. Company managers testified that their business (and therefore its workforce) fluctuated based on customer demand and that they hired the plaintiffs as two of the many independent contractors required to fill specific labor needs on an as-needed, project-driven basis. The company cited various different facts in support of its position that the plaintiffs were not employees when they worked at Honghua. The Plaintiffs countered with their own evidence, arguing that although they signed an agreement to work as independent contractors, they believed they were being hired as employees.

DISTRICT COURT OPINION

Judge Ellison began his analysis by emphasizing that “[t]he FLSA includes an expansive definition of who qualifies as an employee.” To determine if an individual is an employee under the FLSA, Judge Ellison explained, the court must consider whether “as a matter of economic reality, the worker is economically dependent upon the alleged employer or is instead in business for himself.” This inquiry depends on five non-exhaustive factors, including (1) the degree of control exercised by the alleged employer; (2) the extent of the relative investments of the worker and the alleged employer; (3) the degree to which the worker’s opportunity for profit or loss is determined by the alleged employer; (4) the skill and initiative required in performing the job; and (5) the permanency of the relationship.

Judge Ellison found significant material issues of fact with regarding to each of these factors:

- **Control:** The workers said they had little control over their work, their welds were checked by a manager, and that the Company set their work hours. They also said they were required to sign non-compete and non-disclosure agreements.
- **Investment:** The Court found there was conflicting evidence about whether the company provided tools and equipment or whether the plaintiffs were required to bring their own welding equipment to work.
- **Opportunity for Profit/Loss:** The Court found that the company set the Plaintiffs' hours and set a schedule that precluded other work, thus suggesting "that Plaintiffs lacked at least some control over their opportunities for profit and loss." There was also conflicting evidence about whether the Plaintiffs could control their costs, including whether they were required to provide their own equipment or use a particular insurance company required by Honghua.
- **Plaintiffs' Skill and Initiative:** The Court said that "[u]nique skills or an ability to exercise significant initiative within the business are indicative of independent contractor status," yet "routine work which requires industry and efficiency is not indicative of independence and nonemployee status." Honghua argued that Plaintiffs were highly-skilled welders, performed little manual work, and instead focused on supervising lower-skilled welders and working with customers to modify projects as needed. The workers countered that they performed primarily low-skilled or unskilled manual labor under close supervision. Ultimately, the Court found, that "the parties' entirely conflicting account of Plaintiffs' responsibilities prevents the Court from evaluating this factor."
- **Permanency of the Relationship:** Judge Ellison also acknowledged that when a plaintiff's relationship with a defendant is on a project-by-project basis, it is indicative of independent contractor status. The Plaintiffs disputed ever being told that they were being brought on for a temporary basis, and stated that they were advised they would be retained for at least six months, and perhaps a couple of years. The Company disputed these contentions, and Judge Ellison ruled he could not resolve this factual dispute on summary judgment. In addition, although he noted that the Fifth Circuit has previously indicated that a 10-month work engagement "begins to resemble an employment relationship," Judge Ellison concluded that "[t]he length of the relationship, and the factual disputes surrounding what Plaintiffs were told about their positions, preclude the Court from deciding, at the summary judgment stage, what status the permanency of the relationship suggests."

INDEPENDENT CONTRACTOR AGREEMENT NOT DISPOSITIVE

Judge Ellison also rejected the company's contention that the Plaintiffs confirmed themselves as contractors because they signed contracts acknowledging their status as independent contractors, affirmed this status in their tax forms, and have their own businesses. He noted that "[a] person's subjective opinion that he is a businessman rather than an employee does not change his status" and concluded that because substantial factual disputes exist on all of the factors relevant to the Court's determination of status "evidence of how Plaintiffs perceived or identified their status cannot warrant summary judgment."

Because he could not resolve credibility determination on summary judgment and given the many different factual disputes, Judge Ellison denied Honghua's motion for summary judgment.

TAKEAWAY

This case illustrates that the determination of independent contractor status under the FLSA involves a fact-intensive inquiry dependent upon an analysis of the totality of the circumstances. Because these cases hinge on multiple factual determination, winning a contractor misclassification case on summary judgment is oftentimes difficult—even when you have contractor agreements in place.

Even worse, although the U.S. Department of Labor has been targeting the misclassification issue for quite some time now, it has recently started to renew its focus on independent contractors. The DOL has a "Misclassification Initiative," which is focused on preventing, detecting, and remedying employee misclassification. In particular, the DOL is targeting "fissured

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industries,” which it describes as those industries in which it is more likely that workers are performing under independent contractor, subcontractor, franchise, or employment agency relationship.

So what should you do? If you employ independent contractors, make sure to periodically perform an audit to ensure that you have properly classified workers as independent contractors. Your favorite employment counsel can provide advice on how to conduct a wage and hour audit and provide practical solutions for efficiently and cost-effectively managing independent contractor classification reviews. As this case demonstrates, an independent contractor agreement or payments on 1099 forms will not be dispositive. Take some time to review your independent contractor agreements to ensure compliance before one—or more—government agencies reviews them for you. Remember also that different laws may have different “tests” for determining independent contractor status; the standard under the FLSA is generally regarded as the most difficult to meet.

To learn about our Wage & Hour Audit/Assessment solutions for managing pay practice, exempt classification, and independent contractor classification reviews, please click [here](#).

By: *John L. Collins* and *Steve Shardonofsky*

John L. Collins and *Steve Shardonofsky* are both located in Seyfarth Shaw’s Houston office. If you would like further information, please contact your Seyfarth attorney, John Collins at jcollins@seyfarth.com or Steve Shardonofsky at sshardonofsky@seyfarth.com.



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