

DOL ISSUES NEW GUIDANCE ON INDEPENDENT CONTRACTORS

Date: 23 July 2015

United States Labor, Employment and Workplace Safety Alert

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The misclassification of employees as independent contractors continues to be a hot issue and to receive attention at the state and federal levels. Last week, the U.S. Department of Labor, Wage and Hour Division ("DOL") published new guidance addressing misclassification, emphasizing the broad scope of employment under the Fair Labor Standards Act ("FLSA"), and summarily concluding that most workers are employees covered by the FLSA. DOL plans to continue challenging these misclassifications through "robust" enforcement efforts across industries. Employers should expect scrutiny of their independent contractor classifications and should review their classifications to make sure they are appropriate.

DOL's guidance, published as Administrator's Interpretation 2015-1, examines the longstanding, multi-factor "economic realities" test used to determine whether someone is a bona fide independent contractor or an employee for purposes of the FLSA (as well as the Family and Medical Leave Act and the Migrant and Seasonal Agricultural Worker Protection Act). While DOL's guidance does not necessarily announce new law or policy, it certainly takes an expansive view of who is an employee and suggests that the "economic realities" factors should be considered in light of the broad scope of the employment relationship under the FLSA. The guidance also cautions employers to consider all factors and not to rely solely on the amount of control exercised by the employer, which is at the heart of the test applied by other agencies under laws addressing discrimination, taxes, and employee benefits.

The factors to consider under the "economic realities" test, as described and explained by DOL's guidance, are outlined below and seem to indicate that virtually every worker could be considered an employee.

IS THE WORK AN INTEGRAL PART OF THE EMPLOYER'S BUSINESS?

This factor examines the nature of the employer's business and the nature of the individual's work. If someone's work is integral to the business of the employer, it is more likely that the individual is an employee. For example, cake decorators perform work that is integral to a business engaged in selling custom-decorated cakes, and picking pickles is an integral part of a pickle business — and courts have found that these workers are employees and not independent contractors. Recognizing the increase in telecommuting and other flexible work arrangements, the guidance also notes that work performed away from an employer's place of business (such as work performed at home or at a customer's site) can still be considered an integral part of the employer's business.

DOES THE WORKER'S MANAGERIAL SKILL AFFECT HIS OR HER OPPORTUNITY FOR PROFIT OR LOSS?

Courts have also articulated this factor in terms of "the degree to which the worker's opportunity for profit and loss is determined by the alleged employer" or even just "the worker's opportunity for profit or loss." An independent contractor faces the potential of not only making a profit, but also suffering a loss, which often extends beyond a single job. For example, a worker's decision to hire others, purchase materials and equipment, advertise, rent space, and manage time tables reflect managerial skills that may affect profit or loss beyond a worker's current job. According to DOL, the focus should not be merely whether there exists an opportunity for profit or loss, but should be whether the worker can make decisions and use managerial skill and initiative to affect the opportunity for profit or loss. DOL also explains that loss is not simply a reduction in earnings and that the opportunity for profit or loss is different than the ability to simply work more or less hours to increase or decrease earnings, which is something an employee may be able to do.

HOW DOES THE WORKER'S RELATIVE INVESTMENT COMPARE TO THE EMPLOYER'S INVESTMENT?

A worker's investment (and thus undertaking of risk) can be an indication that he or she is in an independent business. However, DOL instructs that a worker's investment should not be considered in isolation, but that the worker's investment should be compared to the investment of the employer and that a worker's relatively minor investment, as compared to the employer's investment, is not indicative of an independent contractor. DOL does acknowledge that some courts have analyzed workers' investments without comparing them to the employer's investments, but seems to discount that approach in favor of cases that have made a comparison part of the analysis.

DOES THE WORK PERFORMED REQUIRE SPECIAL SKILL AND INITIATIVE?

For this factor, DOL instructs employers to focus on the worker's business skills, judgment, and initiative, as opposed to technical skills, as an indication that he or she is an independent contractor. By way of example, highly skilled carpenters or electricians may not be independent contractors if they do not exercise their skills in an independent way and do not demonstrate managerial or business skill. In the context of a carpenter who provides handcrafted, custom cabinets, the skill and initiative of an independent contractor could include marketing, determining when and how many materials to order, and determining which orders to fill.

IS THE RELATIONSHIP BETWEEN THE WORKER AND THE EMPLOYER PERMANENT OR INDEFINITE?

A worker's permanent or indefinite relationship with a purported employer suggests that the worker is an employee. At the same time, DOL cautions that the lack of a permanent or indefinite relationship does not automatically mean that a worker is an independent contractor. Employers should consider the reason why the relationship is not permanent or indefinite. If the lack of a permanent relationship results from the worker's independent business initiative, that would indicate an independent contractor. On the other hand, if the lack of permanence results from operational characteristics of the industry, such as industries that are seasonal or that rely on part-time labor or staffing agencies, that may not indicate that the worker is running an independent business.

WHAT IS THE NATURE AND DEGREE OF THE EMPLOYER'S CONTROL?

This factor considers whether the worker, as opposed to the employer, actually controls meaningful aspects of the work performed, as an indication of an independent contractor relationship. The DOL guidance cites cases in which the court found that workers' control over their hours of work was not enough, alone, to establish that the workers were independent contractors. And it cites caselaw indicating that an employer need not "look over his workers' shoulders every day" in order to exercise control. DOL again warns employers not to place too much weight on this factor or to let it "overtake" the other factors of the "economic realities" test.

DOL suggests that all of these factors be analyzed in light of the ultimate determination of whether a worker is economically dependent on the employer or is truly an independent businessperson. This guidance and DOL's accompanying statements signal an increased focus on, and skepticism of, independent contractors. Even the cases cited in the guidance tend to be those most favorable to workers asserting that they should be considered employees, not independent contractors. In addition to this recent guidance, DOL has created a webpage for its "misclassification initiative" and has entered into a memorandum of understanding with 23 states^[1] and the Internal Revenue Service to combat worker misclassification. Employers in all industries should pay attention to the independent contractor issue and need to be prepared for both increased enforcement activity by DOL, as well as increased private litigation.

Notes:

^[1] These states include Alabama, California, Colorado, Connecticut, Florida, Hawaii, Illinois, Iowa, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Montana, New Hampshire, New York, Rhode Island, Texas, Utah, Washington, Wisconsin, and Wyoming.

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