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Practice Update

Department of Labor: Most Workers Classified As Independent Contractors Are Employees

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On July 15, 2015, the Wage and Hour Division of the Department of Labor declared the misclassification of employees as independent contractors to be "one of the most serious problems" at workplaces in the United States and issued an "Administrator's Interpretation" that it will utilize to combat this issue. In support, DOL emphasized that problems and complaints involving minimum wage, overtime compensation, unemployment insurance, and workers' compensation have increased significantly in light of the misclassification of workers. The focus of the Interpretation is twofold: (i) addressing relevant definitions and extent of employment relationships covered under the Fair Labor Standards Act; and (ii) discussing in detail each factor of the "economic realities" test, which is the test utilized to determine employment status, to provide guidance on whether a worker is an employee or an independent contractor.

First, the Interpretation focused on the FLSA's definition of "employ," which "includes to suffer or permit to work." The Interpretation stressed the broad applicability and importance of the term "suffer or permit" in the analysis of whether a worker is an employee subject to the FLSA's protection. The Interpretation briefly discussed the

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history of the “suffer or permit” standard to reiterate the standard’s broad applicability and to support the notion that the standard “broadens the scope of employment relationships covered by the FLSA.”

Next, the Interpretation addressed the “economic realities” test. While acknowledging that whether a worker is economically dependent on the employer (therefore an employee) or truly in business for him or herself (therefore an independent contractor) is the crucial inquiry under the FLSA, the Interpretation maintained that the multi-factorial “economic realities” test provides key guidance.

According to the Interpretation, the “economic realities” factors, as articulated by various courts over the years, include: 1) the extent to which the work performed is an integral part of the employer’s business; 2) the worker’s opportunity for profit or loss depending on his or her managerial skill; 3) the extent of the relative investments of the employer and the worker; 4) whether the work performed requires special skills and initiative; 5) the permanency or indefiniteness of the worker-employer relationship; and 6) the degree of control exercised or retained by the employer.

After emphasizing that these six factors must be “examined and analyzed in relation to one another, and [that] no single factor is determinative,” the Interpretation discussed each factor using case law and examples to aid in answering the economic dependence inquiry. Below are some of the key portions of the discussion:

1) Extent to which the work performed is an integral part of the employer’s business

In citing various cases, the Interpretation noted that ”[i]if the work performed by a worker is integral to the employer’s business, it is more likely that the worker is economically dependent on the employer.” Work can be integral to an employer’s business even if the work is:

- "just one component of the business and/or is performed by hundreds or thousands of other workers;" or
- "performed away from the employer's premises, at the worker's home, or on the premises of the employer's customers."

2) Worker's opportunity for profit or loss depending on his or her managerial skill

The Interpretation discussed that in analyzing this factor, the focus should be on "whether the worker exercises managerial skills and whether those skills affect the worker's opportunity for both profit and loss." The Interpretation further maintained that a "worker's ability to work more hours" and "amount of work available" are irrelevant in the worker's managerial skills and in determining whether a worker is an independent contractor.

3) Extent of the relative investments of the employer and the worker

The Interpretation emphasized that a minor investment made by a worker can indicate that the "worker and the employer are not on similar footings and that the worker may be economically dependent on the employer." However, the Interpretation also acknowledged that even if a worker makes a substantial investment, it must be compared to the nature and extent of employer's investment to determine whether the worker is truly an independent contractor.

4) Whether the work performed requires special skills and initiative

The Interpretation stressed that a "worker's business skills, judgment, and initiative, not his or her technical skills, will aid in determining whether the worker is economically independent" and hence an independent contractor.

5) Permanency or indefiniteness of the worker-employer relationship

The Interpretation highlighted that while permanency or indefiniteness in a worker-employer relationship suggests that the worker is an employee, the lack thereof does not automatically mean that the worker is an independent contractor. In citing several cases, the Interpretation pointed out that the "key is whether the lack of permanence or indefiniteness is due to 'operational characteristics intrinsic to the industry'."

6) Degree of control exercised or retained by the employer

Finally, the Interpretation noted that a worker "must control meaningful aspects of the work performed such that it is possible to view the worker as a person conducting his or her own business" and thus be classified as an independent contractor.

Surprisingly, the Interpretation further opined that neither an employer's lack of control over workers nor a worker's control over the hours they work generally indicate an independent contractor status.

This Interpretation follows the recently proposed FLSA rule to limit the white collar exemptions. Clearly, the DOL intends to broaden the scope of workers covered by the FLSA. Employers should very carefully audit their independent contractors to make certain they fall within the definition set forth by the government.

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