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INDEPENDENT CONTRACTORS

With the prevalence of companies providing ''on demand'' services today, the temptation to classify workers as independent contractors rather than employees has perhaps never been greater, attorneys Keith Covington and John P. Rodgers say in this BNA Insights article. However the Labor Department's recent interpretive guidance is a signal that the DOL intends to go after those employers that wrongfully classify employees as independent contractors.

Covington and Rodgers say if employers classify their workers correctly under guidance on the DOL's ''economic realities'' test, they can minimize their misclassification risks in the event the DOL comes calling.

Employee or Independent Contractor: The DOL Weighs in on Worker Misclassification

BY KEITH COVINGTON AND JOHN P. RODGERS

Most workers in America are employees and not independent contractors for federal wage and hour purposes, according to recently issued interpretive guidance from the U.S. Department of Labor. This guidance is a clear warning signal to employers that the DOL will be cracking down on employers who misclassify employees as independent contractors.

The new DOL guidance reaffirms that worker misclassification is an issue that's here to stay. The DOL, the Internal Revenue Service, and other government regulators, including state agencies, are stepping up their enforcement efforts against companies they believe are improperly classifying workers as independent contractors. Plaintiffs' attorneys are getting into the act and filing class actions. And, while well-known companies like Uber and FedEx have received much of the high-profile attention, any employer that uses independent contractors to staff its work must take care to follow the guidelines.

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The misclassification issue is especially daunting for employers because the various government agencies responsible for enforcing the tax and employment laws use varying tests for determining whether workers are employees or independent contractors. Some agencies, like the IRS, use a test derived from common law that focuses largely on the employer's ''right of control'' over the worker. The DOL applies a test that emphasizes the ''economic realities'' between the employer and the worker. Others, like Immigration and Customs Enforcement (ICE) and the National Labor Relations Board (NLRB), use other variants of these standards. It is enough to give even the most well-intentioned employer a pounding headache.

So now comes the DOL's new guidance, in the form of a 15-page Interpretation from the Administrator of the DOL's Wage and Hour Division (135 DLR AA-1, 7/15/15). The stated purpose of the Interpretation, issued on July 15, 2015, is to provide employers with ad-

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ditional direction for classifying their workers under the Fair Labor Standards Act and to curtail what the Administrator refers to as the ''problematic trend'' of workers being misclassified as independent contractors. The Interpretation technically does not carry the force of law, but it will serve as the principal guide for the DOL in seeking to enforce the FLSA's overtime and minimum wage requirements. Employers that ignore the new guidance do so at their own peril.

So What's the Impact?

From a purely legal standpoint, the Administrator's Interpretation contains little that is dramatic or new. For many years, in determining whether a worker should be classified as an employee or an independent contractor under the FLSA, both the courts and the DOL have applied a multi-factor ''economic realities'' test that takes into consideration the following six factors: (1) the extent to which the worker's work is an integral part of the employer's business; (2) whether the worker's managerial skill affects the worker's opportunity for profit or loss; (3) how the worker's relative investment compares to the employer's investment; (4) whether the work performed requires special skill and initiative; (5) whether the relationship between the worker and the employer is permanent or indefinite; and (6) the nature and degree of the employer's control.

The Administrator's Interpretation does not purport to change this basic approach. To the contrary, in the Interpretation, the DOL fully reaffirms that this ''economic realities'' test and its six determining factors are appropriate for FLSA purposes.

From a practical standpoint, however, the Interpretation's importance cannot be overstated. The Interpretation states on its face that the DOL believes many workers are being misclassified as independent contractors under the FLSA and that the Interpretation is being issued as part of a ''multi-pronged approach'' to combat those misclassifications. As a result, the Interpretation is a very clear signal that the DOL intends to go after those employers that wrongfully classify employees as independent contractors.

In addition, the Interpretation seeks to ensure that more workers are classified as employees by emphasizing that the ''economic realities'' test must be applied in a manner consistent with the broad coverage of the FLSA. The Interpretation notes that the FLSA's definition of ''employ''—''to suffer or permit to work''—is an expansive concept that was ''specifically designed to ensure as broad of a scope of statutory coverage as possible.'' The Administrator then pronounces that, if the ''economic realities'' test is applied in view of this expansive definition, ''most workers are employees under the FLSA.''

The Interpretation makes clear that the ultimate inquiry under the ''economic realities'' test should be whether the worker is ''economically dependent on the employer or in business for him or herself.'' Accordingly, the six factors analyzed under this test should not be applied in a ''mechanical fashion'' but should be used as ''a guide to make this ultimate determination of economic dependence or independence.''

By emphasizing that the issue is the worker's economic dependence, the DOL is attempting to shift the focus away from whether the putative employer has the right of control over the worker and is clearly trying to expand the FLSA's coverage. As the Interpretation forcefully notes, the '' 'economic realities' test provide[s] a broader scope of employment than the common law control test.''

The remainder of this article will analyze the six ''economic realities'' factors and then provide some practical advice for employers to use to make sure their workers are properly classified under the FLSA.

Factors in DOL Administrator's Interpretation

As stated above, the central question when applying the ''economic realities'' test should be whether the worker is economically dependent on the employer—which is indicative of an employment relationship under the FLSA—or whether the worker is in business for himself or herself—which shows an independent contractor relationship.

With that background in mind, we will now turn to a review of the six factors under the economic realities test (in the order presented in the Administrator's Interpretation).

Is the work an integral part of the employer's business?

As the Seventh Circuit Court of Appeals has noted, if you pick the pickles for a pickle business, then you are an integral part of the employer's business. *Sec'y of Labor v. Lauritzen*, 835 F.2d 1529, 1537-38 (7th Cir. 1987). As this example cited in the Administrator's Interpretation illustrates, if a worker's work is integral to the employer's business, then that makes it more likely that the worker is economically dependent on the employer, according to the DOL. On the other hand, the DOL contends that a ''true'' independent contractor's work ''is unlikely to be integral to the employer's business.''

The DOL provides a residential construction company example to demonstrate: A carpenter who frames houses is integral to the construction company's business and, therefore, most likely an employee. But a software developer who the construction company hires to create software to track bids and orders is more likely an independent contractor because the software developer is performing work that is not integral to the company's business.

Does the worker's managerial skill affect the worker's opportunity for profit or loss?

Whether a worker has an opportunity for profit or loss is irrelevant to this second factor, according to the DOL. Rather, the proper inquiry centers on whether the worker exercises managerial skill and whether that managerial skill affects the worker's opportunity to make a profit or experience a loss.

The more managerial skill a worker exercises, the more indicative of an independent contractor relationship. If the worker is performing tasks such as trying to solicit new business, making hiring decisions, and purchasing materials and advertising space, then that reflects managerial skills that ''will affect his or her opportunity for profit or loss beyond a current job'' and points toward an independent contractor relationship. If a worker lacks managerial skills, then that is indicative of an employment relationship, the DOL's Interpretation instructs.

The Interpretation makes clear that this factor does not turn on a worker's ability to work more hours or the amount of hours an employer offers. The capability to

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work more hours—and thus earn more of a profit on one's labors—has ''nothing to do with the worker's managerial skill'' and does not separate employees from independent contractors, according to the Interpretation. The Administrator also stresses that if a worker is truly in business for himself or herself, and thus an independent contractor, the worker must have the opportunity to suffer a loss.

The DOL provides an example that helps clarify this ''exercise of managerial skill'' analysis: A worker works for a company providing cleaning services to corporate clients. The worker ''produces advertising, negotiates contracts, decides which jobs to perform and when to perform them, decides to hire helpers to assist with the work, and recruits new clients.'' This worker exercises managerial skill that affects his opportunity for a profit or loss and evidences an independent contractor relationship.

On the other hand, a worker who only performs cleaning services—and agrees to work additional hours to earn more—but does not ''independently schedule assignments, solicit additional work from other clients, advertise his services, or endeavor to reduce costs'' does not exercise managerial skill that affects his profit or loss and this points toward an employment relationship.

How does the worker's relative investment compare to the employer's investment?

The third factor analyzes what investment the worker has made in the business. Again, this factor is analyzed within the context of whether the worker is economically dependent upon the employer or in business for himself or herself. For a worker to be in business for himself or herself, the worker typically ''should make some investment (and therefore undertake at least some risk of a loss) in order for there to be an indication that he or she is an independent business,'' according to the DOL's Interpretation. This investment may go toward expanding the business, reducing cost structure, or extending the reach of the market.

The Interpretation instructs, however, that simply because a worker has made an investment does not mean that the worker is an independent contractor. Rather, the worker's relative investment must be compared to the employer's investment for purposes of determining whether the worker is in business for himself or herself. The DOL asserts that the worker's investment should not be ''relatively minor;'' if so, then the ''worker and the employer are not on similar footings and . . . the worker may be economically dependent on the employer.''

One of the factors often examined in determining whether a worker is an employee or independent contractor under the common law control test is whether the worker provides his or her own tools. *See Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 751 (1989) (listing ''source of instrumentalities and tools'' as relevant factor under common law of agency). If a worker provides his or her own tools, then that is indicative of an independent contractor relationship.

The DOL's Interpretation, however, says that this is only part of the analysis. These tools ''may simply be necessary to perform the specific work for the employer.'' The worker's investment must be compared to the employer's investment for purposes of determining whether the worker is really in business for himself or herself.

Even if the investment is possibly a business investment, the worker's investment must be significant in nature and magnitude relative to the employer's investment in its overall business to indicate that the worker is an independent businessperson.

Back to the DOL's cleaning example. There, the worker ''occasionally brings her own preferred cleaning supplies to certain jobs.'' In comparison, the company ''provides insurance, a vehicle to use . . . all equipment and supplies for the worker . . . and invests in advertising and finding clients.'' The DOL instructs that this is indicative of an employee relationship as the cleaning supplies the worker invests in do ''little to further a business beyond that particular job.''

Does the work performed require special skill and initiative?

Under its analysis of the fourth factor, the Interpretation states that technical skills do not help determine whether a worker is economically independent. Rather, the DOL instructs that technically or specially skilled workers are only independent contractors if they operate as independent businesses.

For example, a highly skilled carpenter for a construction company does not exercise independent business judgments, such as determining the sequence of work, ordering additional materials, or thinking about bidding the next job. Rather, the worker is told what work to perform and where. In this scenario, even though the worker is highly skilled, ''he is not demonstrating the skill and initiative of an independent contractor (such as managerial and business skills).'' The DOL states that this carpenter ''is simply providing his skilled labor.'' By contrast, a carpenter who builds customized, made-to-order cabinets would likely be demonstrating the ''skill and initiative of an independent contractor if the carpenter markets his services, determines when to order materials and the quantity of materials to order, and determines which orders to fill.''

Is the relationship between the worker and the employer permanent or indefinite?

The fifth factor considers the length of the relationship between the worker and the employer. If a worker's relationship with the employer is indefinite, then that is indicative of an employment relationship. This is because a worker who is ''truly in business for him or herself'' will want to avoid a permanent or indefinite relationship and the dependence that comes with it, the Interpretation reasons. On the other hand, if the worker's relationship with the employer is project or task specific and the worker does not work continuously or repeatedly for an employer, then that points toward an independent contractor relationship.

As with the other factors, the DOL makes clear that this factor is not dispositive for its purposes. Rather, the reason for the lack of permanence or indefiniteness ''should be carefully reviewed to determine if the reason is indicative of the worker's running an independent business.'' In other words, if a worker's lack of a permanent or indefinite relationship with an employer is the result of the worker's ''own independent business initiative,'' that points toward independent contractor status. Conversely, if a worker jumps from company to company because of the ''operational characteristics intrinsic to the industry,'' then that does not necessarily mean that the worker is an independent contractor, according to the Interpretation.

The following example provided in the Interpretation is instructive: An editor has worked with 15 different publishing houses over the past several years. The editor markets her services to different publishing houses, negotiates rates for each job, and turns down work as she chooses. The DOL instructs that the lack of permanence with one publishing house shows an independent contractor relationship. On the other hand, another editor has worked for one publishing house for several years, and she completes her work in compliance with the publishing house's specifications and only works on books that the publishing house instructs her to work on. Under those circumstances, her lack of permanence is not because she is exercising her own independent business initiative; therefore, it is ''indicative of an employment relationship.''

What is the nature and degree of the employer's control?

The Interpretation's sixth factor highlights the differences between the DOL's ''economic realities'' test under the FLSA and the common law control test. Courts applying the common law test often apply several factors similar to those used for the ''economic realities'' test but state that the ''right to control'' factor is the most important. *See Ill. Conference of Teamsters and Employers Welfare Fund v. Mrowicki*, 44 F.3d 451, 459 (7th Cir. 1994) (''Under the common law, it is 'the hiring party's right to control the manner and means by which the product is accomplished' that determines whether or not an individual is an employee.'') (quoting *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323-24 (1992)).

The DOL's Interpretation, however, emphasizes that the control factor, though pertinent, should ''not play an oversized role in the analysis'' and that ''all possibly relevant factors should be considered.'' If the worker is economically dependent on the employer, then the worker is most likely an employee, even if the employer does not exercise the ''requisite control'' over the worker. The Interpretation states: ''The control factor should not overtake the other factors of the economic realities test, and like the other factors, it should be analyzed in the context of ultimately determining whether the worker is economically dependent on the employer or an independent business.''

In addition to deemphasizing the ''control'' test, the Interpretation shifts the focus somewhat. The common law test analyzes whether the employer has the right to control the manner and means in which the worker does his or her work. The DOL's Interpretation, however, focuses not on the employer but the worker and whether the worker actually exercises control over ''meaningful aspects of the work performed such that it is possible to view the worker as a person conducting his or her own business.''

As part of this analysis, the DOL declares that workers who decide when they work—standing alone—does not show independent contractor status. If the employer still requires the worker to carry out certain tasks, controls how they dress, and exercises other types of control over the worker—regardless of the reason—then the DOL asserts that that ''still indicates that the worker is an employee.''

Overall, it bears repeating that the DOL will analyze these six factors within the context of whether the worker is economically dependent upon the employer. If economic dependence is shown, then that is indicative of an employment relationship, but if the factors point toward the worker being in business for him or herself, then that is indicative of an independent contractor relationship. To state the obvious, these factors on their face seem to be skewed in favor of a finding of employment status in most cases.

Interplay With Other Laws

So if an employer applies the six factors discussed above to determine whether a worker is an employee for wage and hour purposes, is the employer supposed to apply the same test for purposes of determining whether the worker is an employee for tax purposes? For immigration compliance purposes?

As previously noted, in determining whether workers should be classified as employees or independent contractors, employers must contend with a wide array of standards and tests that vary from law to law. The DOL's ''economic realities'' test used to enforce the FLSA is but one test in a confusing hodgepodge of tests applied by the various government agencies and the courts.

The IRS, the NLRB, and ICE all apply different standards in dealing with the worker misclassification issue. These other standards place considerable emphasis, to varying degrees, on the question of the employer's ''control'' over the worker.

The Administrator's Interpretation is an analysis of the DOL's ''economic realities'' test and, therefore, should have little, if any, direct bearing on how these other agencies apply their particular standards. In fact, the analysis set forth in the Administrator's Interpretation is rooted largely in the FLSA's broad definition of ''employ''—to ''suffer or permit'' to work—which does not apply in these other contexts. On the other hand, the Administrator's Interpretation does specifically note that the new guidance applies to the Family and Medical Leave Act (FMLA) and the Migrant and Seasonal Agricultural Worker Protection Act (MSPA) because both of those laws borrow the definition of ''employ'' from the FLSA.

Many employers historically have used the ''control'' factor as the lynchpin in determining how to classify their workers. Unfortunately, this is clearly not enough under the FLSA. In other words, even if a worker is properly classified as an independent contractor for other purposes, that classification could still prove problematic in the event of a DOL enforcement action. To ensure full compliance with all the laws, including the FLSA, an employer clearly must go beyond the ''control'' test and assess whether its employees are truly ''economically independent'' under the broad ''economic realities'' standard addressed in the Administrator's Interpretation.

As a practical matter, this means that the new DOL guidance will also have an important indirect effect on how workers are treated for tax and other employment purposes. If an employer must classify a worker as an employee under the FLSA, it would be an administrative nightmare for the employer to treat that same worker as an independent contractor for purposes of compliance with the other tax and employment laws.

So What's an Employer to Do?

In light of the renewed emphasis that the DOL is placing on the misclassification of workers, employers

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that rely on independent contractors would be wise to take steps now to avoid potential liability.

First, employers should review their contractor relationships and assess whether those relationships are defensible in view of the new guidance. If there is a written contract, the employer should not rely on how that document characterizes the relationship or describes the work terms.

An independent contractor relationship does not exist simply because there is a piece of paper that refers to the worker as an independent contractor. What really matters is how the worker actually interacts with the employer and what the worker is actually doing in his or her job. Employers should audit their contractor relationships as they exist on-the-ground to see if they would withstand DOL scrutiny. Prudent employers will do this before they are staring down the barrel of a DOL investigation.

Second, in doing this review and assessment, employers should not ignore the Administrator's Interpretation's clear message that the proper inquiry is whether the worker is ''economically independent'' of the employer. An analysis that places too much weight on the issue of the ''control'' over the worker issue is not sufficient.

The Administrator's Interpretation states that there are five other factors that an employer must consider and an employer acts at its own peril if it disregards that mandate. If a worker works for only one employer, there is going to be a strong presumption that the worker is ''economically dependent'' on that employer and, thus, its employee.

Third, employers should consider whether their independent contractor arrangements should be reworked in order to render them more defensible. A work arrangement that is permanent or indefinite as to duration will likely not pass muster. If the worker is placed under a contract to perform a particular project or to work for some relatively short period of time, that should factor in the employer's favor. Arrangements—formal or informal—that dictate how the worker is to perform his job should also be avoided.

Instead, employers should focus their contractual relationships on the results that the employer wishes to achieve, not how the worker achieves the results.

Finally, if there is any real doubt, employers should assume that their workers will be considered employees, and treat them as such. Employers should not fool themselves into thinking that a worker will be considered an employee simply because some of the factors point toward independent contractor status.

If a worker's work is an integral part of the employer's business, convincing the DOL that the worker is anything other than an employee is going to be especially difficult now. Employers should not forget that the Administrator's Interpretation was issued precisely because the DOL wants to tip the balance more toward employee status.

Conclusion

With the prevalence of companies providing ''on demand'' services today, the temptation to classify workers as independent contractors has perhaps never been higher. As the DOL's Interpretation reminds us though, the rise of the ''1099 economy'' comes with significant risks for businesses as the DOL zeroes in on worker misclassification. However, if employers are mindful of the new guidance on the DOL's ''economic realities'' test and classify their workers correctly under that guidance, they can minimize their misclassification risks in the event the DOL comes calling.