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U.S. Department of Labor Offers New Insight on the Misclassification of Independent Contractors

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By Michael S. Kun, Dean L. Silverberg, Jeffrey M. Landes, Susan Gross Sholinsky, Michael D. Thompson, Jeffrey H. Ruzal, and Judah L. Rosenblatt*

As federal, state, and local governments have focused in recent years on what they have termed "wage theft," the classification of workers as independent contractors has been the subject of agency audits and litigation (including class actions and collective actions) across the country. On July 15, 2015, the Administrator of the Wage Hour Division of the U.S. Department of Labor ("DOL") issued Administrator's Interpretation No. 2015-1 ("Interpretation") addressing how businesses should distinguish between employees and independent contractors to avoid misclassification of workers under the Fair Labor Standards Act ("FLSA").

The Interpretation may have a significant impact upon many businesses as it confirms not only that the DOL will continue to focus on the status of workers who are classified as independent contractors, but that it will do so with something approaching a presumption that "most workers are employees." And the Interpretation is likely to be used in litigation challenging the classification of workers as independent contractors.

The Interpretation refers to the FLSA's broad definition of the term "employ" and its intended expansive coverage for workers. In so doing, the Interpretation cites the DOL's "economic realities" test for indicia of employment, emphasizing certain aspects of that test.

The DOL's economic realities test typically includes six factors: (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 of the relationship, and (6) the degree of control exercised or retained by the employer.

Notably, the Administrator states that the goal of the "economic realities" test is to determine whether a worker is "economically dependent" on the putative employer, or is really in business for himself or herself.

In the Interpretation, the DOL analyzes the "economic realities" factors as follows:

1. **Is the Work an Integral Part of the Employer's Business?**

To the extent that a worker's job responsibilities are consistent with the putative employer's business, the worker is more likely to be an employee than an independent contractor. The Interpretation emphasizes that a worker's duties are likely to be deemed an "integral part" of an employer's business if they relate to the employer's core products or services.

For example, the Interpretation cites the U.S. Court of Appeals for the Seventh Circuit's decision in *Secretary of Labor v. Lauritzen*, a self-described "federal pickle case" in which the issue was "whether the migrant workers who harvest the pickle crop of defendant … are employees … or are instead independent contractors." Summarizing the point, the Interpretation quoted the Seventh Circuit's statement in *Lauritzen* that it "does not take much of a record to demonstrate that picking the pickles is a necessary and integral part of the pickle business."

2. **Does the Worker's Managerial Skill Affect the Worker's Opportunity for Profit or Loss?**

The Interpretation emphasizes that the opportunity for profit or loss by a worker reflects independent contractor status only when it is dependent on managerial skill. By contrast, the Administrator opines that the fact that a worker can increase his or her earnings by working longer hours for the putative employer is not evidence that the worker is an independent contractor.

3. **How Does the Worker's Relative Investment Compare to the Employer's Investment?**

In previous statements, including a May 2014 Fact Sheet and a presentation on employment relationships under the FLSA on its website, the DOL indicated that the relative investment of a worker compared "favorably" if the investment was *substantial* and could be used for the purpose of sustaining a business beyond the particular job or project that the worker was performing. In the Interpretation, however, the Administrator appears to place a greater emphasis on a *comparison* of the investments made by the worker and those made by the potential employer. The Administrator opines that even if a worker has made an investment (in tools or equipment, for example), his or her investment needs to be significant when compared to the investment of the putative employer.

4. **Does the Work Performed Require Special Skills and Initiative?**

The Interpretation asserts that it is a worker's *business* skills as an independent business person, not his or her *technical* skills, that support independent contractor status. In other words, according to the Administrator, even the most skilled worker is still an employee if he or she does not know how to run a business.

5. **Is the Relationship Between the Worker and the Employer Permanent or Indefinite?**

The Interpretation states that a relationship of an indefinite (or permanent) period is evidence of an employment relationship and notes that independent contractors are typically retained on a project-by-project basis. The DOL further notes that working for other employers does not indicate a lack of "permanence."

The DOL's May 2014 Fact Sheet on independent contractor status stated that having a relationship of a defined duration does not suggest independent contractor status when arising from "industry-specific factors" or the fact that the potential employer "routinely uses staffing agencies." The Interpretation supplements this criteria by stating that the finite nature of any independent contractor relationship should be the result of the worker's "own business initiative," and not simply the fact that in the particular industry in question, engagements are usually of a short-term nature. Thus, an employer that seeks to avoid unintended employment relationships through policies that limit the duration of its independent contractor relationships should consider whether such policies will continue to achieve the desired results.

6. **What Is the Nature and Degree of the Employer's Control?**

Although control has traditionally been one of the most significant aspects of the economic realities test, the Interpretation devalues this factor. The Interpretation emphasizes that an independent contractor must control "meaningful aspects" of the work in order to demonstrate that the worker is conducting (and controlling) his or her own business. The Interpretation does not specifically explain, however, what aspects of a job are "meaningful." The Administrator makes clear that, in today's economy, flexible work arrangements are common forms of employment, and a worker is not necessarily an independent contractor simply because he or she may work outside of the putative employer's office, and set his or her own hours.

What Employers Should Do Now

Given the new guidance, employers should:

- audit their independent contractor workforce, considering the six-factor "economic realities" test and whether the contractor in question is truly in business for himself or herself;

- in connection with such an audit, consider redefining relationships with current independent contractors in a manner consistent with the Interpretation to the extent that the economic realities of the relationship more closely reflect employment status; and

- as always, consider the operational feasibility and financial implications of employing workers instead of contracting with a contingent workforce.

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For more information about this Advisory, please contact:

Michael S. Kun Los Angeles 310-557-9501 mkun@ebglaw.com	**Dean L. Silverberg** New York 212-351-4642 dsilverberg@ebglaw.com	**Jeffrey M. Landes** New York 212-351-4601 jlandes@ebglaw.com
Susan Gross Sholinsky New York 212-351-4789 sgross@ebglaw.com	**Michael D. Thompson** Newark 973-639-8282 mdthompson@ebglaw.com	**Jeffrey H. Ruzal** New York 212-351-3762 jruzal@ebglaw.com

**Judah L. Rosenblatt*, *a Summer Associate (not admitted to the practice of law) in Epstein Becker Green's New York office, contributed to the preparation of this Advisory.*

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