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“Most Workers Are Employees” – The Impact of the New DOL Misclassification Guidance

All businesses that use independent contractors must take an up-close look at those relationships, in light of new interpretive guidance from the U.S. Department of Labor (DOL). The DOL asserts that “most workers are employees” for purposes of the Fair Labor Standards Act (FLSA), and sends a strong message that it will continue to aggressively police how employers classify workers. The guidance, issued on July 15, 2015, expresses the DOL’s concern that misclassification is a significant problem for workers (fewer benefits and statutory protections) and the economy (lower tax revenues for the government and a competitive disadvantage for businesses that properly classify their workers). Thus, the DOL says that the new guidance is aimed at providing assistance to employers and employees in understanding classification standards and will thereby help curtail misclassifications. Significantly, the guidance applies not just to the determination of worker status under the FLSA, but also under the Family and Medical Leave Act and the Migrant and Seasonal Agricultural Worker Protection Act.

“Employ” = “To Suffer or Permit to Work”

The FLSA defines “employ” as “to suffer or permit to work.” This definition, according to the DOL, results in a broader scope of employment than the common law control test. Put simply, a company “suffers or permits” an individual to work for it if, as a matter of economic reality, the individual is dependent on the company.

Under the FLSA, courts use a six-factor “economic realities” test to root out whether workers are economically dependent on the employer or are in business for themselves. All of the factors must be analyzed and no single factor is determinative. The goal in applying the factors, says the DOL, is to make an ultimate determination of economic independence or dependence. What’s more, contractual “labels” are irrelevant to the analysis, so an independent contractor agreement or the fact that the employer issued a 1099-MISC to the worker is not indicative of an independent contractor relationship.

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The Economic Realities Factors

The guidance runs through the factors used in the economic realities test and provides analysis and examples of how to apply them. Here's an overview:

1. *Is the work an integral part of the employer's business?* If the work performed by a worker is integral, it is more likely that the worker is economically dependent on the employer. So, work performed by cake decorators is integral to the business of selling custom-decorated cakes, and "picking the pickles is a necessary and integral part of the pickle business." The DOL provides an example of a construction company that frames houses. Carpenters would be integral to the business of framing homes. On the other hand, the construction company might contract with a software developer to assist the company in tracking bids or scheduling projects. In that circumstance, the software development work is not integral to the construction company's business. The DOL further explains that work can be integral even if it is just one component of the business, if it is also performed by many other workers (such as a worker answering calls at a call center along with hundreds of others), or if it is performed away from the employer's premises (such as with telework and flexible work arrangements).
2. *Does the worker's managerial skill affect the worker's opportunity for profit or loss?* Workers in business for themselves may make a profit or experience a loss. The DOL focuses on whether the worker's *managerial skill* (for example, decisions on hiring, purchasing, or managing timetables) can affect his or her profit and loss, such as by leading to additional business from other parties or by reducing the opportunity for future work. In contrast, a worker's ability to work more hours and the amount of work available from the employer have nothing to do with the worker's managerial skill and do little to separate employees from independent contractors; that's because both are likely to earn more if they work more and if there is more work available.

Consider two workers who provide cleaning services for corporate clients. One performs assignments only as determined by a cleaning company and with no responsibility or ability to schedule assignments, solicit additional work or advertise his services, and he regularly agrees to work more hours in order to earn more. The other worker produces advertising, negotiates contracts, decides which jobs to

perform and when to perform them, hires helpers and solicits new clients. Both of these workers have an opportunity to earn more by working more. But only the second worker is exercising managerial skill that affects his opportunity for profit and loss, which is indicative of independent contractor status.

3. *How does the worker's relative investment compare to the employer's investment?* Independent contractors typically make investments that support their businesses beyond any particular job. And even if there is an investment, it has to be analyzed not just with respect to its nature, but more importantly relative to the employer's investment. For example, says the DOL, investing in tools and equipment is not automatically a business investment or capital expenditure that indicates independent contractor status. The tools and equipment may simply be necessary to perform the specific work for the employer. And even where something is a business investment, it must be significant in "nature and magnitude relative to the employer's investment in its overall business." If the worker's investment is relatively minor, that will indicate that the worker and employer are not on similar footing and that the worker may be economically dependent on the employer.
4. *Does the work performed require special skill and initiative?* A worker's business skills, judgment, and initiative, rather than any technical or specialized skills, will aid in determining whether the worker is economically independent. The guidance uses the example of carpenters, construction workers, and electricians, who often are hired as independent contractors. Only those who operate as independent businesses – such as providing services for a variety of construction companies, marketing their services, determining when to order materials and which projects to work on – demonstrate the skill and initiative of independent contractors. On the other hand, workers who provide similar skilled labor are more likely to be economically dependent on the construction firm if they do not make independent judgments at the job site beyond the work they are doing for that particular job.
5. *Is the relationship between the worker and the employer permanent or indefinite?* Permanency or indefiniteness indicates that the worker is an employee. A worker who is in business for herself typically avoids a permanent or indefinite relationship because of the resulting economic dependence on the company. And even if the working relationship for an employee lasts just weeks or months or is at-will, there is likely some permanence to it, says the DOL, as compared to an independent

contractor who typically does one project for a company and does not necessarily work for the company continuously or repeatedly. In any case, lack of a permanent or indefinite relationship indicates independent contractor status only if it is due to the worker's independent business initiative.

6. *What is the nature and degree of the employer's control?* The worker must control "meaningful aspects of the work performed" in order to be viewed as conducting his or her own business. The DOL points out that the control cannot just be theoretical; the worker must actually exercise the control to qualify as an independent contractor. So, for example, the fact that an employer lacks control over workers who telecommute or work offsite would likely be insignificant in determining the worker's status. The DOL emphasizes that if the employer actually exercises control over a worker, the employer's reasons or motivations for doing so – perhaps due to the nature of the business, regulatory requirements, the desire to ensure customer satisfaction, or the fact that technological advances/mechanisms may make such control possible – are irrelevant.

Action Steps for Employers

The guidance sums up by declaring that "most workers are employees under the FLSA's broad definitions" and by emphasizing that the DOL will continue to crack down on misclassification. Employers that currently use contractors should consider taking prompt action to evaluate (under the auspices of an attorney-client privileged audit) whether the workers are properly classified and to weigh options for fixing any misclassification problems to avoid potentially costly agency enforcement efforts and litigation. The guidance, *Administrator's Interpretation No. 2015-1: The Application of the Fair Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who Are Misclassified as Independent Contractors*, is available [here](#).

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