Legal Backgrounder

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ISO: Uniform, Transparent Regulatory Standard to Distinguish Independent Contractors from "Employees"

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Since enactment of the Fair Labor Standards Act (FLSA), courts and regulatory agencies have struggled, and failed, to develop a consistently-applied test for distinguishing between employees and independent contractors. Vacillating between a common-law control test and an economic-realities test, courts and agencies have even combined the two tests into a hybrid test at times without providing much-needed bright-line rules. In today's "gig" economy, workers and employers alike require predictability in forging their employment relationships. Current approaches have led to contradictory and often divisive outcomes, leaving employers and workers in need of a clear and consistent approach.

Uniform reliance on the common-law control test for worker categorization should be policymakers' goal. This Legal Backgrounder discusses three possible options for achieving that goal: (1) US Department of Labor (DOL) issuance of new sub-regulatory guidance returning to the common-law test; (2) uniform adoption by the courts of the common-law test; and (3) passage by Congress of new or clarifying legislation mandating application of the common-law test.

Background

In 2015, DOL's Wage and Hour Division issued an Administrator's Interpretation which purportedly clarified that the economic-realities test was the proper method of classifying workers under the FLSA.[1] That document guided DOL wage-and-hour enforcement until June 7, 2017, when new DOL leadership withdrew the Interpretation.[2] That withdrawal alone, however, leaves open the question of which test the agency will utilize going forward: economic realities or common-law control. It is critical to understand the distinctions between these tests.

The **economic-realities test** is a multi-factor inquiry meant to determine whether a worker is economically independent or dependent on the employer for his livelihood. Courts do not consider any one factor in the analysis dispositive, and some courts weigh the six test factors differently than others. While the test supposedly examines the "realities" of the relationship, in practice, those economic

[1] U.S. Dep't of Labor, Wage & Hour Div., Opinion Letter on Fair Labor Standards Act (July 15, 2015).
[2] Press Release, U.S. Dep't of Labor Withdraws Joint Employer, Independent Contractor Informal Guidance (June 7, 2017), https://www.dol.gov/newsroom/releases/opa/opa20170607.

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realities often are subjectively evaluated, resulting in varied application of the elements.[3] This tendency has led to inconsistent results, making it difficult for employers and workers to rely on the economic-realities test for predictable outcomes.[4] As the now-withdrawn Administrator's Interpretation suggested, the economic-realities test would classify most workers as employees under the FLSA. This provides little room for the parties to contract for alternative outcomes, even though many workers in the current economy prefer the flexibility and lifestyle options gained by being an independent contractor.

The **common-law control test**, by contrast, focuses on whether an employer controls the manner and means by which a worker provides services.[5] The Internal Revenue Service (IRS), which shares an interest in proper employment classification, uses eleven factors when classifying workers. These factors can be broken down into three categories: business control, financial control, and the nature of the relationship.[6] An employer-employee relationship is created only when the facts show that an employer controls both what the worker does and how the worker does it.[7] Under this framework, the intent of the parties and the actual nature of their relationship are relevant, and courts do not have free rein to speculate beyond what the current evidence actually shows.

Potential Avenues for Adoption of the Control Test

The June 7 withdrawal of the Obama-era Administrator's Interpretation was a necessary first step in DOL's movement toward a common-law control test for the FLSA. However, the agency must take further steps. For instance, DOL has not yet removed all references to the economic-realities test from its website.[8]

Another step DOL should consider is having the Wage and Hour Division issue informal sub-regulatory guidance, such as an Administrator's Interpretation. That guidance would bring DOL in line with the IRS and other federal agencies that apply some form of the control test for worker classification. The Interpretation, however, does not directly govern how state regulatory agencies distinguish between independent contractors and employees. As of June 2017, DOL had entered into agreements with 37 states to collaborate in enforcing the proper classification of workers.[9] While the agreements did not adopt a particular classification test, and did not obligate the parties to promote the policies of the other, the economic-realities test, not the control test, was the prevailing standard at DOL at the time states entered into those agreements, and many state agencies have issued their own guidance adopting the

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[3] *See* Opinion Letter, *supra* note 1.

[4] *Compare, e.g.*, *Mendel v. City of Gibraltar*, 727 F.3d 565 (6th Cir. 2013) (volunteer firefighters were employees) *with Freeman v. Key Largo Volunteer Fire and Rescue Dept., Inc.*, 494 Fed. Appx. 940 (11th Cir. 2012) (volunteer firefighters were independent contractors).

[5] *See Clackamas Gastroenterology Assocs., P.C. v. Wells*, 123 S. Ct. 1673, 1680-81 (2003).

[6] Internal Revenue Service, *Topic 762 – Independent Contractor vs. Employee*, https://www.irs.gov/taxtopics/tc762.html (last visited June 21, 2017); *see also*, Dean L. Silverberg, *Who is your Employee?: Independent Contractors and Other Contingent Workers*, Epstein Becker & Green, P.C., at 19-20.

[7] *See ibid*.

[8] U.S. Dep't of Labor, Wage & Hour Div., *Fact Sheet 13: Am I an Employee? Employment Relationship Under the Fair Labor Standards Act (FLSA)* https://www.dol.gov/whd/regs/compliance/whdfs13.htm (last updated May 2014); U.S. Dep't of Labor; Wage & Hour Div., *Get the Facts on Misclassification Under the Fair Labor Standards Act*, https://www.dol.gov/whd/regs/compliance/whdfs14.pdf (last visited June 21, 2017) (referring to Fact Sheet 13 for more information on the factors used to determine classification status); U.S. Dep't of Labor, *Employment Relationship Under the FLSA*, https://www.dol.gov/whd/flsa/employmentrelationship.ppt (last visited June 21, 2017).

[9] U.S. Dep't of Labor, Wage & Hour Div., *Misclassification of Employees as Independent Contractors*, https://www.dol.gov/whd/workers/misclassification/ (last visited June 21, 2017). Certain of these agreements have expired.

economic-realities test. To achieve national uniformity in worker classification, state regulators would also need to embrace DOL's preference for the common-law control test.

A second approach for achieving uniform, equitable categorization of workers would focus on moving the federal judiciary toward embracing the common-law control test. Currently, courts employ different classification tests depending on which employment law statute is at issue. The test in the FLSA context "is one of 'economic reality,'" but the Supreme Court has left open the question of which factors courts should use in that analysis.[10] The Court clarified that the FLSA, "was obviously not intended to stamp all persons as employees who … might work for their own advantage on the premises of another."[11] In Title VII and Americans with Disabilities Act cases, courts use either the control test or a hybrid of the control and economic-realities tests.[12] In Employee Retirement Income Security Act and National Labor Relations Act (NLRA) cases, courts still employ the control test.[13] When litigating misclassification cases, employers could argue that courts should not use the economic-realities test because it leaves little room for parties to contract freely for any status other than employee.

Change through the courts will no doubt be expensive, time consuming, and incomplete. Such a strategy is predicated on convincing judges to apply the common-law standard in cases brought by private litigants. Because it is unlikely that judges in disparate parts of the country will all adhere to the preferred approach, divergent outcomes will result, which ultimately the US Supreme Court could decide to resolve. Because some courts in misclassification disputes might be willing to defer to clearly elucidated federal employment-regulation standards, it is critical that DOL issue the reasoned interpretive statement suggested above.

While the uncertainties of administrative and judicial action might hamper progress, recent decisions of the Supreme Court with respect to pleading standards might allow employers to litigate misclassification claims in a novel way. "Economic realities" is a problematic concept, allowing for widely varying interpretations and potential for judges to make gut-level determinations that are inconsistent with what really occurs in the modern marketplace. The plausibility pleading standard required under the Supreme Court's *Twombly* and *Iqbal* decisions[14] could prove to be a useful sword for employers in defending against FLSA classification claims, especially if armed with new DOL guidance, who might demand that workers plead with specificity the facts establishing their alleged employee status in objective terms of control. Such motions to dismiss could decrease the number of frivolous suits and avoid lengthy and expensive discovery, while ultimately leading to the adoption of a standard based on criteria for demonstrable control.

The third strategy for change in worker classification—federal legislation mandating national application of the control test—offers the greatest potential to create durable uniformity and certainty. Lately, Congress has mostly considered amendments to the FLSA that would expand the law's reach.[15]

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[10] *See Tony & Susan Alamo Found. v. Sec'y of Labor*, 471 U.S. 290, 296. (1985).
[11] *Id.* at 300 (quoting *Walling v. Portland Terminal Co.* 330 U.S. 148, 153 (1947)).
[12] *See, e.g.*, *Knitter v. Corvias Military Living, LLC*, 758 F.3d 1214 (10th Cir. 2014) (Title VII case); *Burton v. Freescale Semiconductor, Inc.*, 798 F.3d 222 (5th Cir. 2015) (ADA case). *But see Escribano-Reyes v. Professional Hepa Certificate Corp.*, 817 F.3d 380 (1st Cir. 2016) (using right-to-control test in ADA/ADEA case).
[13] *See, e.g.*, *Dykes v. DePuy, Inc.*, 140 F.3d 31 (1st Cir. 1998) (ERISA case); *Lancaster Symphony Orchestra v. NLRB*, 822 F.3d 563 (D.C. Cir. 2016) (NLRA case).
[14] *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).
[15] *See* Silverberg, *Who is your Employee?*, *supra* note 6, at 15-16.

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Federal legislators' efforts are far better invested in codifying the common-law control test for FLSA enforcement. Congress took this same action 70 years ago with the NLRA and the Social Security Act (SSA). In 1947 and 1948, in reaction to a series of US Supreme Court decisions embracing the economic-realities test for federal labor laws,[16] Congress clarified that federal agencies and courts should utilize common-law agency principles when determining worker status under those two laws.[17] Unfortunately, legislators never clarified application of the common-law test for the FLSA, which defines "employee" in a circular fashion: "any individual employed by an employer."

An amendment to the FLSA would simply bring that statute's definition of employee in line with the two other New Deal-era labor laws Congress fixed seven decades ago. Such a legislative solution would ensure that employers and workers could predict how regulators and courts will analyze their relationships. It would also prevent future DOL leadership from simply reversing agency guidance and related policies.

The current climate on Capitol Hill is such that advancing any legislative proposal is challenging, let alone legislation in the always contentious realm of employment regulation.[18] Proponents of the common-law test for worker categorization under the FLSA, however, have a very compelling case to make, and they can certainly demonstrate the role reform of the NLRA and the SSA in the 1940s had in post-World War II economic growth.

Conclusion

Employers and workers each deserve a uniform standard to determine questions of worker classification under the FLSA. Given the flexibility sought by employers and workers in performing services in the new economy, the application of an economic-realities test, which would classify nearly every worker as an employee, does not meet these needs. The control test offers a familiar alternative that is already used in many statutes. DOL, courts, and Congress should immediately move toward embracing the time-tested common-law standard.

[16] *NLRB v. Hearst Publications*, 322 U.S. 111 (1944); *United States v. Silk*, 331 U.S. 704 (1947).

[17] *See* 61 Stat. 137, ch. 120, Title I § 101 (1947) and 62 Stat. 438, ch. 468, § 2(a) (1948).

[18] On July 12, 2017, the House Committee on Education and the Workforce held a hearing on the related issue of "Redefining Joint Employer Standards: Barriers to Job Creation and Entrepreneurship," and on July 13, 2017, the Appropriations Subcommittee on Labor, HHS, Education, and Related Agencies marked up their FY 2018 bill to narrow the definition of joint employment. The marked-up appropriations bill was approved on strict party lines, indicating that a deep partisan divide remains concerning any such legislation.

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