SULLIVAN & CROMWELL LLP

July 17, 2015

U.S. Department of Labor Issues Administrative Guidance Regarding Classification of Workers as Independent Contractors or Employees

Guidance Takes A Stringent Position on the Determination of Whether Workers Can Be Considered Independent Contractors

SUMMARY

On July 15, 2015, the U.S. Department of Labor issued an Administrative Interpretation (the "Guidance") setting forth the Department's position on when workers can be considered independent contractors instead of employees covered by the Fair Labor Standards Act (the "FLSA").[1] The Guidance states that the Department believes that "most workers are employees under the FLSA's broad definition" of "to employ" and the test it enunciates similarly is rigorous. The Guidance describes and sets out the Department's interpretation of six factors that courts have used to determine whether a worker should be classified as an employee covered by the FLSA, and thus subject to provisions such as the minimum wage and overtime pay, or as an independent contractor, and provides examples designed to illustrate the application of each factor. The Guidance, which comes shortly after a proposal regarding changes in overtime regulations, is part of the Department's larger effort to expand the scope of the FLSA coverage, including by "curtailing" what it considers the increasing "misclassification" of employees as independent contractors.

BACKGROUND

The FLSA defines an "employee" as a person "employed by an employer" and defines "to employ" as "to suffer or permit to work." The new Guidance reads the words "suffer or permit to work" extremely broadly,

and maintains that it was Congress's intent—by specifically using that phrase in the FLSA's definition of "employ"—to expand the common law test for an employee-employer relationship to cover a broad universe of workers.

Further, given that the FLSA's definitions are not particularly helpful in determining who is an employee, courts have developed multi-factor tests designed to evaluate the "economic realities" of the worker's relationship with the employer. The Guidance takes the position that the main focus of the economic realities test, irrespective of the particular factors used by various courts, should be whether the worker is economically dependent on the employer, in which case the worker should be considered an employee. According to the Guidance, "a worker who is economically dependent on an employer is suffered or permitted to work by the employer," and thus falls under the FLSA's definition of employee.

THE GUIDANCE'S ANALYSIS

The Guidance reviews six factors courts commonly assess as factors relevant to the economic realities of the worker-employer relationship: (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. The Guidance states that "no single factor is determinative" and that the factors' significance should be assessed "in totality" by "a qualitative rather than quantitative analysis."

1. The extent to which the work performed is an integral part of the employer's business.

If the work performed is integral to the employer's business, the Guidance asserts that it is likely that the worker is economically dependent on the employer and, thus, an employee. The Guidance emphasizes that work can be integral even if it is performed by hundreds or thousands of other workers, such as a worker in a call center, or if it is performed away from the employer's premises, such as at the worker's home or on the premises of the employer's customers. As an example, the Guidance states that a carpenter's work is integral to a construction company's business; by contrast, a software developer retained to create a program to track orders may not be as integral to such a business and, thus, the software developer may be retained as an independent contractor.

2. The worker's opportunity for profit or loss depending on his or her managerial skill.

If a worker exercises managerial skills, those skills affect the worker's opportunity for profit and loss and, thus, reflect that the worker is "in business for himself" and is not economically dependent on an employer. The Guidance specifically rejects the idea that a worker's ability to work more hours of his own volition is relevant to his classification, as both employees and independent contractors "are likely to earn

more if they work more and if there is more work available." Rather, the Guidance looks to whether the worker manages his own work in a broad sense. The Guidance contrasts a cleaner whose jobs are determined by the company he works for, with a cleaner who advertises his own business, negotiates contracts for himself, and decides which jobs to perform and when to perform them; the former is an employee and the latter may be an independent contractor.

3. The extent of the relative investments of the employer and the worker.

In order for a worker to be considered an independent contractor, the Guidance states that the worker's investment "must be significant in nature and magnitude relative to the employer's investment in its overall business." For example, a cleaner who buys the cleaning supplies he uses on the job does little to further his employer's business, but a cleaner who rents his own space to store the cleaning supplies that he buys, advertises his own services and hires help for larger jobs, has made a significant investment in his overall business.

4. Whether the work performed requires special skills and initiative.

Specialized skills suggest that a worker is an independent contractor if they are "used in some independent way, such as demonstrating business-like initiative." The Guidance distinguishes between the exercise of business skills, judgment and initiative from mere technical skills. To illustrate this, the Guidance contrasts two highly skilled carpenters, one of whom does not exercise his skills in an independent manner but is "told what work to perform where," and the other who specializes in made-to-order handcrafted cabinets and independently determines what work he will take on.

5. The permanency of the relationship.

The Guidance states that "permanency or indefiniteness in the worker's relationship with the employer suggests that the worker is an employee" and "a worker's lack of a permanent or indefinite relationship with an employer is indicative of independent contractor status," but only so long as that indefiniteness "results from the worker's own independent business initiative." The Guidance notes that even occasional workers can be considered employees: "operational characteristics intrinsic to industry," such as seasonal work or the use of staffing agencies, does not indicate that workers are independent contractors. For example, a book editor who has worked intermittently with 15 different publishing houses, negotiating rates for each job and accepting work as she pleases, is indicative of the impermanence of an independent contractor relationship.

6. The nature and degree of control exercised or retained by the employer.

If the worker can "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," then the worker likely is an independent contractor. The Guidance nevertheless claims that the "control factor should not play an oversized role in

the analysis of whether a worker is an employee or an independent contractor." The Guidance takes the position that the fact that technology allows companies to retain workers without control over the physical space they work in, for example, does not mean those workers are independent contractors. The Guidance provides the example of a registered nurse listed with a registry that matches her with clients but requires that she adhere to the registry's wage requirements and work hours, a degree of control indicative of an employment relationship, with a nurse whose registry allows her to work for as many or as few clients as she chooses and to negotiate her own wage rate and schedule, a degree of control not indicative of an employment relationship.

IMPLICATIONS

Employers may wish to review their classification decisions.

The Department's Guidance, although neither legally binding nor particularly surprising given past pronouncements, nonetheless provides clear confirmation that, from the Department's perspective, very few workers should be classified as independent contractors. The Department has made misclassification a priority through its Misclassification Initiative and recent enforcement actions. Thus, employers may wish to consider reviewing their classification decisions in light of this focus and the Department's restrictive analysis.

The Guidance is part of the Department's larger focus on minimizing exclusions from FLSA requirements.

In June 2015, the Department issued proposed rules designed to limit the number of employees eligible for exclusion from overtime under the FLSA. We described the proposed rules in our July 1, 2015 memorandum, which can be found here. Those proposed rules, coupled with this Guidance, underscore an active initiative by the Department to increase the number of workers who can claim coverage under the FLSA.

* * *

ENDNOTE(S)

[1] Wage & Hour Div., U.S. Dept. of Labor, Administrator's Interpretation 2015-1 (July 15, 2015), *available at* http://www.dol.gov/whd/workers/Misclassification/AI-2015_1.htm.

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 800 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Stefanie S. Trilling (+1-212-558-4752; trillings@sullcrom.com) in our New York office.

CONTACTS

New York

Robin D. Fessel	+1-212-558-3832	fesselr@sullcrom.com
Tracy Richelle High	+1-212-558-4728	hight@sullcrom.com
Theodore O. Rogers, Jr.	+1-212-558-3467	rogersto@sullcrom.com
Christina Andersen	+1-212-558-4851	andersenc@sullcrom.com