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Alert

Recent Department of Labor Actions Seek to Limit Independent Contractor Misclassification and Raise the Salary Requirements for Overtime Exemption

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On July 15, 2015, the U.S. Department of Labor (DOL) issued Administrator's Interpretation No. 2015-1 (the "Interpretation") to address misclassification of independent contractors under the wage and hour requirements of the Fair Labor Standards Act (FLSA). Also, on June 30, 2015, the DOL issued a proposed regulation amending the exemption tests for "white collar" employees under the FLSA. Both of these actions highlight the need for employers to re-examine their classifications of individuals as contractors or as exempt from overtime pay requirements.

Misclassification of Workers as Independent Contractors

The July 15 Interpretation stresses that the definition of employee is very broad under the FLSA and that most workers should be classified as employees rather than independent contractors. The Interpretation asserts that worker misclassification is occurring frequently and, consequently, employees are not receiving "important workplace protections such as the minimum wage, overtime compensation, unemployment insurance, and workers' compensation."[1]

The Interpretation emphasizes that the FLSA's definition of employ — which is "to suffer or permit to work" — and the "economic realities" test developed by the courts in evaluating FLSA claims provide a "broader scope of employment than the common law control test."[2] The Interpretation analyzes each of the following six factors of the "economic realities" test:

1. Whether the work performed 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. Whether the worker is retained on a permanent or indefinite basis;
4. Whether the worker's investment is relatively minor as compared to the employer's investment;
5. Whether the worker exercises business skills, judgment and initiative in the work performed; and
6. Whether the worker has control over meaningful aspects of the work performed.

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[1] Administrator's Interpretation No. 2015-1, at 1.

[2] *Id.* The common law test is utilized by the Internal Revenue Service and in other circumstances where "employee" is not defined.

The Interpretation highlights the importance of the first factor above and appears to deemphasize the sixth factor. The Interpretation states that "whether the worker's work is an integral part of the employer's business should always be analyzed in misclassification cases."[3] With respect to the sixth factor, the Interpretation stresses that the "control" factor "should be analyzed in light of the ultimate determination of whether the worker is economically dependent on the employer or truly an independent businessperson."[4] The DOL appears to suggest that the "control" factor — which is typically key to the common law test — should not be the focus of a court's analysis, stating that it "should not play an oversized role in the analysis of whether a worker is an employee or an independent contractor."[5] The Interpretation concludes by stating that "most workers are employees under the FLSA's broad definitions" and the "factors should be used as guides to answer that ultimate question of economic dependence."[6]

In contrast to the Interpretation, the U.S. Court of Appeals for the Second Circuit recently affirmed a lower court ruling that used the "economic realities" test to strike down a FLSA class action suit brought by a group of umpires for the U.S. Open tennis tournament. The Second Circuit, contrary to the Interpretation, focused primarily on the "control" factor in making its decision, stating that "the critical inquiry in determining whether an employment relationship exists pertains to the degree of control exercised by the purported employer over the results produced or the means used to achieve the results."[7]

The DOL began issuing administrator interpretations in March of 2010. Thereafter, there was uncertainty as to what weight the interpretations would carry and what level of deference they would be afforded by courts. The U.S. Supreme Court recently ruled that because administrator interpretations do not require agencies to undertake notice and comment procedures, they are not to be afforded the same deference that regulations are given, stating, "When courts give 'controlling weight' to an administrative interpretation of a regulation — instead of to the best interpretation of it — they effectively give the interpretation — and not the regulation — the force and effect of law."[8] Courts, therefore, are not required to give the same high level of deference to DOL interpretations as they do to regulations issued by the DOL.

Proposed Salary Requirement Under the FLSA

The FLSA generally requires employers to pay the minimum wage to employees and overtime pay for each hour they work in excess of forty hours. However, among the FLSA's exemptions is one for employees who are paid on a salary basis and earn a certain minimum amount per week. To be exempt, these employees also must meet a "duties test" which determines whether the employee falls under one of the "white collar" exemptions which include, among others, executive, administrative and professional employees.[9]

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[3] *Id.* at 6.

[4] *Id.* at 13.

[5] *Id.* at 14.

[6] *Id.* at 15.

[7] *Meyer v. U.S. Tennis Ass'n*, No. 14-3891-CV, 2015 WL 3938148, at *1 (2d Cir. June 29, 2015) (internal citation marks omitted).

[8] *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1221 (2015).

[9] For a more detailed analysis of the professional exemptions, please see our prior *Alert* "The New Overtime Regulations."

The DOL's June 30 proposed regulation sets forth an increase in the salary requirement from $455 per week to $970 per week. Although the DOL did not propose amending the "duties test" for the exemptions, it did request comments on the "duties test," which may result in amendments as well.

The DOL proposed that the salary level should be increased to an amount equal to the 40th percentile of earnings for full-time salaried workers. The current salary threshold is $23,660 per year. The DOL estimates that the new threshold, if approved, would be $50,440 in 2016. The DOL also proposed establishing a mechanism for automatically updating the salary levels on an annual basis. The current threshold was set in 2004 and has not changed. The DOL further proposed an increase to the minimum salary required to qualify for the "highly compensated employee" exemption from $100,000 in total annual compensation (including non-discretionary bonuses) to the 90th percentile of earnings for full-time salaried employees ($122,148 per year).

Although the DOL's proposed regulation requested comments on the duties test, the DOL suggested that the salary level proposal may negate the need for any duties test changes, stating it "believes that the salary level increase proposed … , coupled with automatic updates to maintain the effectiveness of the salary level test, will address most of the concerns relating to the application" of the "white collar" exemption.[10]

The public comment period for the proposed amendments ends on Sept. 4, 2015. There is a high level of participation expected, which may necessitate an extension of the comment period. It is unlikely that the rule will be finalized this year. Employers, however, should take the opportunity to review the classifications being used for current employees.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[10] The DOL's proposed regulations are available online.