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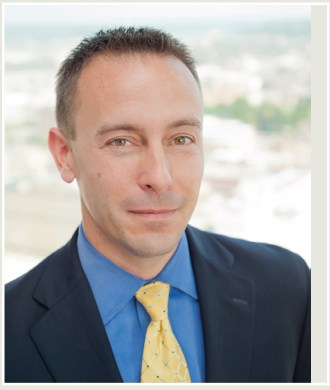
Legal Update

A Case of Mistaken Identity

Department of Labor Issues Updated Fact Sheet On Independent Contractor/Employee Classification Issues



Chad E. Willits
Partner

Email: CWillits@Rendigs.com
Direct: 513 381 9297
Fax: 513 381 9206

The use of independent contractors has become an increasingly common business practice. It affords a business the benefit of workers with specialized expertise, while eliminating administrative burdens typically associated with an employee/employer relationship, such as minimum wage and overtime obligations, payroll taxes, employee benefits, Worker's Compensation premiums, and the like.

However, misclassifying a bona fide employee as an independent contractor – either intentionally or inadvertently – can result in serious consequences, including enforcement actions and liability for back wages, back taxes, and other fines and penalties. Because many of the legal protections available to employees do not apply to independent contractors, the U.S. Dept. of Labor has made such misclassification a top priority enforcement focus over the past few years.

Recently, the DOL Wage and Hour Division issued Fact Sheet No. 13 in an attempt to clarify the factors it examines to determine employee/independent contractor status for purposes of the Fair Labor Standards Act ("FLSA") which governs overtime and minimum wages. Fact Sheet 13 can be found on the DOL website. While it provides some insight about how the DOL conceptualizes the distinction between an employee and an independent contractor, the Fact Sheet is largely consistent with Federal case law on these issues and offers little new guidance to employers.

The Fact Sheet confirms the DOL's focus on the economic nature of these relationships. The DOL views workers "who are economically dependent on the business of the employer" as highly likely to be employees. It describes independent contractors on the other hand, as workers with "economic independence who are in business for themselves." This economic dependence/independence theme is reflected throughout the six factors the DOL identifies for consideration.

Specifically, in determining whether an employment relationship exists under the FLSA, the DOL will consider the following:

1. The extent to which the work performed is an integral part of the employer's business. – If an individual performs tasks for the company similar to the work the company does for its customers, the worker is much more likely to be classified as an employee.
2. Whether the worker's managerial skills affect his or her opportu nity for profit and loss. – If a worker exercises independent business judgment or operates as an independent business in open market

Rendigs, Fry, Kiely & Dennis, LLP
600 Vine Street, Suite 2650
Cincinnati, Ohio 45202

competition with other similar businesses, they are likely to be classified as an independent contractor.

3. The relative investment in facilities and equipment by the worker and the employer. – A worker who shares the risk of the venture by investing in tools, equipment, and facilities is likely to be classified as an independent contractor.
4. The worker's skill, initiative, and exercise of independent business judgment. – The more control exercised by the worker/contractor, including the ability to hire and supervise other workers, the more likely they are to be classified as an independent contractor.
5. The permanency of the worker's relationship with the business. – The DOL views permanent or long-lasting working relationships as suggestive of an employment relationship, rather than that of an independent contractor.
6. The nature and degree of control by the employer. – If the business retains control of how the work is to be performed, rather than simply specifying the end result, the worker is very likely to be classified as an employee.

This last factor – the authority to control how the work is performed – is always a key consideration, including specifics like the method and manner used, working hours, pay amounts, and the like. Although the Fact Sheet suggests this factor holds no greater weight than the other five, this is always a critical detail for businesses to consider, since many State laws and other federal regulations rely heavily on this particular factor.

Perhaps the biggest challenge and frustration for businesses dealing with worker classification issues is the lack of clear guidance to help determine who is an employee and who is an independent contractor. Like much of the existing case law, Fact Sheet #13 offers little in the way of specifics or bright lines.

To the contrary, the Fact Sheet expressly confirms that there is "no single rule or test" for determining whether an individual worker is an employee or independent contractor. Instead, the DOL will look to "the totality of the working relationship," and consider "all facts relevant to the relationship." Businesses can therefore expect any DOL analysis to be multi-factored, fact-specific, and conducted on a case-by-case basis.

Interestingly, the Fact Sheet warns against over-reliance on two common practices used by businesses to address worker classification issues. Specifically, the DOL will not view a written independent contractor agreement or the fact that the worker has incorporated as an independent business as determinative factors in classifying the worker as an employee or independent contractor.

Certainly, no business should rely on either of these two details as conclusive, since the DOL and any other investigating agency will examine much more closely the day-to-day reality of the relationship between the business and the worker, regardless of the label that the company may apply on paper. Nevertheless, although the DOL views these two practices as "immaterial" for purposes of worker classification under the FLSA, there are still many good reasons to follow these practices in conjunction with other worker classification precautions.

For example, a clearly-written Independent Contractor Agreement can guide the daily reality of a company's relationship with a worker, and clarify other important details like responsibilities for wages, Worker's Compensation premiums, and the right to control or supervise the manner in which work is performed. Similarly, the fact that a worker/contractor is organized as an independent business entity can further demonstrate its economic independence from the putative employer, its ability to compete and work for others in the open market, and similar details. Although the DOL may place little weight on these practices, they can nevertheless have important implications under many parallel State laws that govern worker classification.

While the DOL Fact Sheet offers little in the way of new or specific guidance, it serves as an important reminder that the Federal Government is continuing its enforcement focus on these issues. Businesses are wise to educate themselves on the standards — clear or otherwise — used to classify workers as employees or independent contractors, due to the important legal implications that accompany these relationships.

Chad Willits' *practice is concentrated on employment law, admiralty and maritime law, insurance coverage, and general civil litigation in Ohio and Indiana. He has extensive experience and an active pre-trial, trial, and appellate practice in these areas.*

Chad also assists businesses and organizations with risk management and related proactive planning to prevent or resolve claims before they escalate into expensive lawsuits. These services include drafting and implementing workplace policies and practices, management training, and overseeing internal investigations and audits.