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Contractor rules expand employer risks

FLSA audits can help keep litigation at bay

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New Labor Department guidance on classifying workers as employees versus independent contractors is expected to increase litigation against employers.

Experts recommend that firms, particularly those with a significant numbers of independent contractors, conduct an audit now to ensure they are classified properly under the Fair Labor Standards Act, though the expectation is that fewer workers will be classified as independent contractors.“I don't think that's going to happen overnight, but I do think the cumulative effect of private litigation and the DOL's focus on this issue is likely going to lead to fewer employers using that model over time,” said Ted Boehm, an associate at law firm Fisher & Phillips L.L.P. in Atlanta.Though the July Labor Department guidance contains no new regulations per se, its emphasis on the alleged misclassification of many workers as independent contractors is a warning that the department will pursue the issue, which experts say also will encourage plaintiff attorneys.There is insurance coverage to protect employers from such liabilities, however.Experts also note that the latest guidance is part of a broader push to help workers, including Labor's June issuance of its long-awaited proposal to change overtime exemptions for executive, administrative and professional employees that effectively would make more people eligible for overtime.There is also a financial component to the independent contractor issue since the government can collect taxes from employees more easily than independent contractors, observers say.“The guidance can be categorized as not necessarily totally new, but pushing the interpretation of court decisions to the broadest extent possible in order to obtain coverage for more workers under federal wage-and-hour laws,” said Matthew S. Disbrow, a partner at Honigman, Miller, Schwartz and Cohn L.L.P., Detroit.“The most surprising thing to us” is the focus on the worker's economic dependence on the employer, where historically it has been on “who is actually controlling the worker” as he does his job, said Allan S. Bloom, a partner at Proskauer Rose L.L.P., New York.Many firms need independent contractors and the latest guidance will make it more “difficult” to use these workers, “but at least it's some guidance employers can come and look at in ascertaining whether or not their workers are properly classified,” said E. Jason Tremblay, a partner at Arnstein & Lehr L.L.P. in Chicago. According to the U.S. Bureau of Labor Statistics, there were 10.3 million independent contractors nationwide in 2010.Employers that do not “re-emphasize” their employment relationships “will

become more susceptible to litigation," said Drew E. Pomerance, a partner at Roxborough, Pomerance, Nye & Adreani L.L.P. in Woodland Hills, California. Workers who challenge their firms' job classifications "will be more likely to be correct because the guidelines are clearer," he said.There is general agreement that the interpretation will lead to more putative class action litigation being filed against employers. Pointing to the independent contractor and overtime issues, Mr. Boehm said, "I don't think it takes a genius to predict that both of those actions will likely inspire new and more claims." In July, for instance, the 7th U.S. Circuit Court of Appeals held that 479 drivers in Kansas for Memphis, Tennessee-based FedEx Corp. were employees and had been improperly classified as independent contractors. Now is "the perfect time for companies to start looking at their classifications across the board" and audit their current practices, Mr. Bloom said."Many companies have not necessarily been paying the attention they should pay to what goes into determining how to properly classify someone," said Jennifer L. Anderson, a partner at Jones Walker L.L.P. in Baton Rouge, Louisiana. "If a company suspects it has classification problems, it should reach out to labor counsel before doing anything and get appropriate options and advice on the steps to take," she said. "Avoid the knee-jerk reaction. That can sometimes create more problems than doing nothing."Many observers point to a phrase within the guidance — "most workers are employees under the FLSA" — as the key to the document, which also says an increasing number of workplaces are misclassifying employees as independent contractors.The guidance said in order to determine whether a worker is an employee or an independent contractor under the FLSA, courts use the "economic realities" test.Factors to be considered under this test, which the Labor Department said is being used by courts to evaluate the issue, are: the extent to which the work performance is an integral part of the employer's business; the worker's opportunity for profit or loss depending on his or her managerial skill; the extent of the relative investments of the employer and the worker, such as tools and equipment; whether the work performed requires special skills and initiatives; the permanency of the relationship; and the degree of control exercised or retained by the employee.