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Wage & Hour Cases: FLSA Changes and Employee vs. Independent Contractor

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FLSA Changes and Employer vs. Independent Contractor Differences

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Salary Raises:

The Fair Labor Standards Act (the "FLSA") is a federal mandate that governs wages and working hours for employees. The regulations are intended to protect the workforce from excessive hours of work, as well as to ensure adequate levels of compensation. Generally, the FLSA protects non-exempt workers by mandating minimum wage be paid and any time worked over 40 hours in a workweek be paid at 150% of the worker's hourly rate. A worker's status as being non-exempt is generally presumed. However, many employees fall under an exemption such as the "White Collar" and or "Highly Compensated Employee" exemptions, whereby they are exempt from the overtime requirements of the FLSA.

Employees can qualify as exempt or non-exempt in a number of ways. Generally under the White Collar exemption, an employee must meet three criteria to be considered exempt: salary basis, salary level, and the duties test. The above criteria under the FLSA have not been updated since 2004. However, President Obama issued a memorandum to the U.S. Department of Labor (DOL) in March 2014 directing the regulations of the FLSA be modernized and updated to better keep pace with the modern economy. The DOL was tasked with considering how the FLSA regulations could be updated; yet still remain consistent with the intent of the Act. The DOL specifically addressed the ever changing nature of the workplace and

the need for simpler regulations so both workers and employers could better understand them and apply them correctly.

In July 2015, the DOL released their proposed updated regulations governing the payment of minimum wage and overtime pay to "white collar workers." The overall objective of the proposed regulations is to increase the number of employees classified as non-exempt. While the criteria framework used to determine if someone is exempt remains relatively the same, the application of each criterion will be revised based on the proposed changes.

Under the current regulations, an employee must first be paid on a salary basis. Being paid on a salary basis is where the employee receives full pre-determined and fixed salary for any week in which the employee performs any work, without regard to the number of hours or days worked, or the quality or quantity of work. Second, the employee's weekly salary level must be at the "minimum specified amount" of $455 per week ($23,660 per year) for exemption. Lastly, the employee's job duties must primarily involve executive, administrative, or professional duties as defined by the regulations in the Wage and Hour Division's Part 541 regulations.

The proposed regulatory revisions aim to: 1) set the standard salary level at the 40th percentile of weekly earnings for full-time salaried workers ($921 per week, or $47,892 annually); 2) increase the total annual compensation requirement (currently $100,000 annually) needed to exempt highly compensated employees to the annualized value of the 90th percentile of weekly earnings of full-time salaried workers ($122,148 annually); and 3) establish a mechanism for automatically updating the salary and compensation levels going forward to ensure that they will continue to provide a useful and effective test for exemption.

In reality, based on the Bureau of Labor Statistics projections, the proposed regulatory changes would raise the standard salary threshold from the present values to about $970 per week ($50,440 per year) in 2016. The DOL estimates that the proposed changes would result in 4.6 million currently exempt employees to lose their exemption right away, along with another 500,000 to 1 million employees losing their exemption status over the next 10 years due to the automatic increases to the salary level threshold.

While it appears the salary basis and salary level elements of the test are being changed significantly, it is yet to be determined if the duties test aspect of the inquiry will be altered. The proposed rule does not include any revisions to the duties requirements for an employee to be exempt under the white collar exemptions. However, the DOL is seeking comments on whether the duties tests accurately screens out employees who are not bona fide executive, administrative, or professional employees. Many speculate that the DOL will adopt the California model of the duties test which requires white collar employees spend at least 50% of their working time performing exempt tasks. It is undetermined as of now whether the final rule will include a significant update to the duties test.

Just as with any proposed regulatory update, the proposal has been met with a variety of concerns. The U.S. House of Representatives Subcommittee on Workforce Protections held a hearing to discuss the proposal and identified the following concerns: 1) the proposed threshold is too high for entry level purchasing, manufacturing, and engineering; 2) the salary threshold may be inappropriate for rural, southern, and low cost of living areas; and 3) the proposed threshold would raise costs and is a direct formula for exporting work to lower cost of living countries. Other concerns, recognized by the DOL, are that employers are likely to reduce the working hours of currently exempt employees affected by the new regulations. Consequently,

the reductions in hours will likely lead to lower overall pay for these reclassified employees. To combat some of those concerns for employers, the DOL is considering including certain commissions and bonuses to satisfy the salary level requirements.

The final rule is certain to upset some and cause others to rejoice. However, employers would be wise to begin to prepare now. Employers should begin to prepare by identifying employees who are currently classified as exempt, but earning less than the projected salary threshold of $50,440. Employers need to evaluate the effect that the new threshold amounts will have on the overall organizational structure of the company and identify any other costs associated with making changes based on the proposed rule. Companies should also evaluate their employment policies and job descriptions, and make certain there are distinctions between exempt and non-exempt employees that are accurate and consistent with the regulations. Further, employers should prepare to offer the necessary and required training to employees who are soon-to-be reclassified as non-exempt; including, but not limited to, time-card policies, restrictions on working over normal hours, meal and break requirements, and overtime procedures and authorization policies.

The new proposed regulations are causing companies to have to seriously evaluate their budgetary concerns, management, and overall organizational structures. Nonetheless, the likely result of the proposed changes will result in many more workers falling under the parameters and protections of the FLSA's wage and overtime requirements.

Misclassified Employee:

New guidance offered by the Department of Labor's Wage and Hour Division (WHD) warrants sweeping changes in the classification of independent contractors and employees under the Fair Labor Standards Act (FLSA). Concerned for years with the

misclassification of employees as independent contractors, the Department of Labor (DOL) issued an "Administrator's Interpretation" on July 15, 2015 aiming to provide clear guidance on the question of who is properly considered an "employee" and covered by the FLSA, and who is not.

An Administrator's Interpretation (AI) is an agency interpretation that is not subject to the notice and comment process required for rulemaking. Therefore, the AI does not have the force of a regulation that has been properly issued after the notice and comment period. While an AI is not binding on the courts, courts often look to the interpretations for guidance and treat them with varying degrees of deference. One can never be sure how the courts will implement a specific interpretation, but considering the recent interpretation's bold assertion that most workers are employees under the FLSA's broad definitions, employers would be wise to revaluate their own employee classification systems and expect eagerness by the DOL to prosecute and punish employers who have misclassified their independent contractors.

By severely restricting the use of independent contractors, the Administrator seeks to require businesses to reclassify their independent contractors as employees subject to the requirements of the FLSA, including minimum wage and overtime protections. Under the FLSA, a worker is considered an employee if he or she is "economically dependent on the business of the employer, regardless of skill level." To determine the employee's dependence on the business, courts consider six "economic realities factors." The six factors are:

- The extent to which the work performed is an integral part of the employer's business;
- Whether the worker's managerial skills affect his or her opportunity for profit or loss;
- The worker's investment when compared to the employer's investment;

- The worker's business skill, judgment, and initiative;
- The permanency or indefiniteness of the worker's relationship with the employer; and
- The nature and degree of the employer's control over the worker.

The DOL's guidance clearly moves away from the traditional concepts of what it means to be an independent contractor, and instead, focuses more on the totality-of-the-circumstances. The guidance specifically states there is no one factor that controls the classification analysis, and there is no mechanical way to apply the factors. Rather, the guidance announced a "qualitative" application of the "economic realities" test to classify independent contractors, whereby the FLSA should be "construed to provide broad coverage for workers." The DOL, based on recent court decisions and specifically a Sixth Circuit opinion, cites to the historic foundation of the FLSA's definition of "employ," whereby if a worker is economically dependent on the employer, the worker is "suffered or permitted to work" and is an employee under the FLSA.

The "economic realities" test aides in determining whether an entity "suffers or permits to work" individuals who are entitled to the FLSA's statutory protections. Generally, the AI states the test as whether the worker is really in business for him or herself (thus an independent contractor) or is economically dependent on the business (thus an employee). The recent guidance rejects as a determinative factor the parties' understanding of their relationship, as well as whether an agreement regarding the nature of their relationship existed between the parties. The AI states: "[A]n agreement between an employer and a worker designating or labeling the worker as an independent contractor is not indicative of the economic realities of the working relationship and is *not relevant* to the analysis of the worker's status." (Emphasis added).

Therefore, the parties' beliefs, labels, and agreements are not determinative in the classification analysis. Instead, a rigorous application of the test must be utilized.

The DOL's guidance on misclassification comes on the heels of the recently released proposal to overhaul the FLSA's exemptions for executive, administrative, professional, outside sales, and computer employees (White Collar Exemptions). Within the proposed regulations, the DOL seeks to increase the minimum salary threshold for exemption from the overtime requirements for certain white collar employees by more than 100 percent and an increase in the minimum compensation required for the application of the "Highly Compensated Employee Exemption." These proposals, along with the recent misclassification guidance, clearly display the DOL's intention to ensure that many more workers are covered by the minimum wage and overtime protections of the FLSA.

The DOL's misclassification guidance concludes with the explanation that "In sum, most workers are employees under the FLSA's broad definitions." Consequently, it would behoove employers to revaluate their classification systems and prepare for the DOL to aggressively target employers that misclassify employees as independent contractors. Failing to take notice of the new guidance and implementing new procedures could expose employers to significant liability under the FLSA. The DOL is permitted to award liquidated damages and back pay, assess civil money penalties up to $10,000 for minimum wage and overtime violations, and further a second conviction could result in imprisonment. Moreover, employers who repeatedly violate the requirements may be fined by the DOL up to $1,100 per violation. Therefore, a careful review of employment practices and policies should be done by employers before the regulations become effective in 2016 as expected.