Employee Misclassification and the "Economic Realities" Test

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A worker who performs a function that is an "integral part" of the employer's business is less likely than ever to be treated as an independent contractor.

In a recent regulatory pronouncement discussing the Fair Labor Standards Act (FLSA), U.S. Wage and Hour Administrator David Weil addressed the issue of misclassification of workers as independent contractors.

Administrator's Interpretation No. 2015-1, which carries the force of law, refers repeatedly to the "economic realities" test, one of two tests commonly applied to determine whether an employment relationship exists. It concluded that, under that test, "most workers are employees under the Fair Labor Standards Act."

Weil discussed six factors that are commonly addressed by the courts in applying the economic realities test. In addition to the five factors listed below, one factor that the Wage and Hour Division appears to weigh among the strongest in determining whether an employment relationship exists is the one that refers to whether the service performed by the worker is an *integral part* of the alleged employer's business.

Weil referred to the "integral part" factor as "compelling," but what, exactly, does "integral" mean in this application?

The Interpretation provides one example with reference to the construction industry, noting that, for a company that frames residential homes, carpenters are performing a service that is integral to its business. In contrast, workers performing other services for the same

company (the example utilized was software development services) are more marginal to the company's business; thus, those workers are not "integral."

In other words, is the worker performing a service that is a part of the company's ultimate product or service? If so, then it may be very difficult, at least in the context of the FLSA, for a company to assert that the worker should appropriately by classified as an independent contractor. The Interpretation specifically states that the factor of whether the worker's services are "integral" should be at least addressed in virtually every circumstance.

The other factors discussed in the Interpretation are:

- the degree of the potential employer's right to control the manner in which the work is to be performed;
- the alleged employee's opportunity for profit or loss depending on his managerial skill;
- the potential employee's investment in providing the services, such as by purchasing materials or equipment, or engaging the assistance of others;
- the degree of skill required to perform the services; and
- the longevity and permanence of the working relationship.

When the company is in control of how the work is performed, or when a worker obtains the lion's share of their work from a single source, an employment relationship will most likely be found.

In addition to addressing the issues mentioned above, the Administrator's Interpretation provides agency guidance in connection with the Department of Labor's continuing enforcement efforts aimed at what it views as widespread misclassification of workers as other than employees.

Employers would do well to view the Interpretation as a warning to employers that may have, either intentionally or inadvertently, improperly characterized employees as independent contractors.