insights

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A Newsletter from Shumaker, Loop & Kendrick, LLP | Autumn 2015

Your Drivers Are Now Your Employees:

Independent Contractors under the New Labor Paradigm

The U.S. Department of Labor (the "DOL") has been hard at work this summer, as the end of President Obama's second term draws to a close. The DOL has finally formalized its longstanding trend of challenging independent contractor classifications into actual guidance, in the form of Administrator's Interpretation No. 2015-1 (the "AI"), the one and only interpretation of the Fair Labor Standards Act ("FLSA") the DOL has issued this year. While this interpretation falls far short of an actual regulation, it remains the only available DOL guidance on independent contractor issues since the Wage & Hour Division ceased issuing opinion letters in 2009. In formulating this analysis, the WHD Administrator has opted to ignore the long-standing policy and practice under which entire segments of the economy have functioned for decades. This article will review the AI's formulation of the FLSA's economic realities test and then apply it to one critical segment of the economy—the motor carrier industry.

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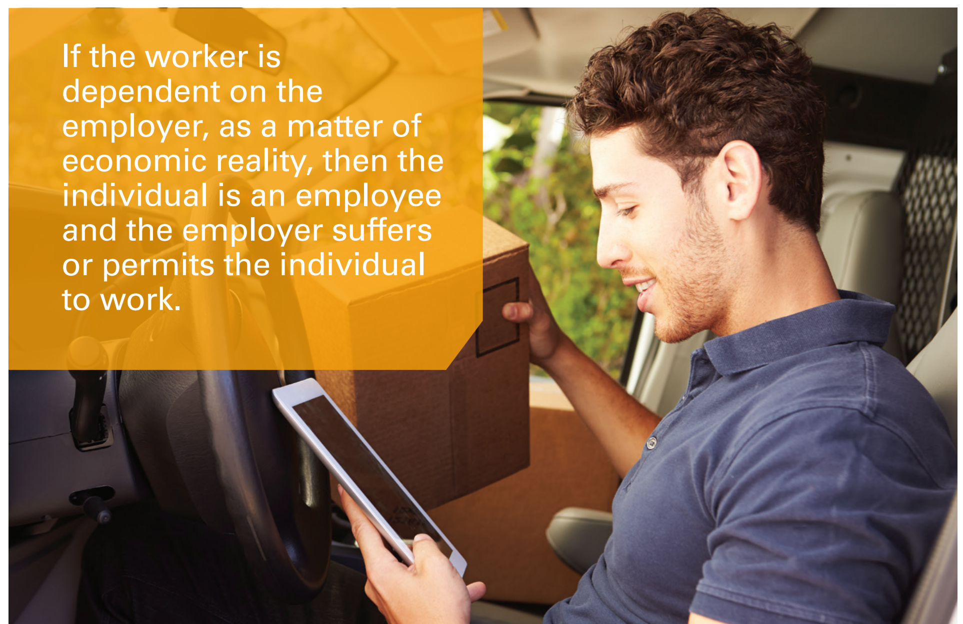

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The Economic Realities Test under the FLSA

The independent contractor model is firmly entrenched in various industries, and encompasses outside sales representatives, owner-operator haulers, software consultants, skilled tradesmen and others who perform work that is not subject to the control of any employer. While most courts rely on the common law "right to control" test to determine whether a worker is properly classified as an independent contractor in workers' compensation, tax, and other contexts in which this issue can arise, the DOL stands firmly on the side of a more rigid test, known as the "economic realities" test, which applies under the FLSA.

According to the Administrator, this test stems from the definitions used in the FLSA, which defines "employ" quite broadly, to include "to suffer or permit

to work." (29 U.S.C. 203(g)) This broad definition was designed to include third parties who illegally hired child laborers when the FLSA was enacted, to prevent employers from using agents to evade the FLSA's requirements. Thus, the "suffer or permit" standard broadens the scope of employment relationships covered by the FLSA, to include those entities who "suffer or permit" an individual to work if, "as a matter of economic reality, the individual is dependent on the entity." (AI at 4)

Thus, the thrust of the economic realities test is to determine whether the worker is really in business for himself or herself, and therefore truly independent. If the worker is dependent on the employer, as a matter of economic reality, then the individual is an employee and the employer suffers or permits the individual to work. The economic realities test includes the following factors, and no one factor is more important than the others:

1) **Integral to the Business.** If the work the worker performs is integral to the business, then it is more likely that the worker is economically dependent on the employer.

2) **Worker's Opportunity for Profit/Loss Based on Managerial Skill.** A worker in business for himself faces the possibility of profit, but also the risk of loss. The worker's managerial skill affects the opportunity for profit and loss beyond the current job. Managerial skill includes such decisions on whether to hire others, purchase materials and equipment, whether to advertise, whether to buy or rent space and management of time schedules and scarce resources. If the worker's decision in such areas impacts the profit/loss of the business, more so than working more or fewer hours or having technical abilities, then the worker is more likely to be an independent contractor.

3) **Relative Investments of the Employer and the Worker.** The worker should make some investment (and therefore undertake at least some of the risk for a loss) in order to indicate that the business she is operating is truly independent. And this investment must not be relatively minor when compared with that of the employer, it must be significant in nature and magnitude relative to the employer's investment. In the examples, the AI cites to case law where even a rig welder's investment in an equipped truck costing between $35,000 and $40,000 did not indicate the rig welder was independent, when contrasted against the employer's much more significant investment in its business.

4) **Whether the Work Performed Requires Special Skills and Initiative.** The AI considers a worker's business skills, judgment and initiative, not technical skills, in determining whether this factor is met. This factor is really more of a reminder that just because carpenters, construction workers and electricians are typically considered independent contractors, it is not because of their specialized technical skills that are used to actually perform the work. It is because of their business skills and initiative, which are used in an independent way to operate independent businesses.

5) **Permanent or Indefinite Relationship Between the Worker and Employer.** According to the AI, permanency or indefiniteness in the worker's relationship with the employer suggests that the worker is an employee. Typically, independent contractors work one project for an employer, and do not work continuously or repeatedly for an employer. However, a lack of permanence does not equate to an independent contractor relationship. The "operational characteristics intrinsic to the industry" are relevant to this inquiry, which is to say, the lack of permanence must result from the worker's own independent business initiative in seeking out other work, and not simply be the result of the industry norm.

6) **Nature and Degree of Control Exercised by the Employer.** The worker must control meaningful aspects of the work, such that the worker is actually conducting his own business. In addition, the worker's control must be more than theoretical; the worker must actually exercise it. Thus, a contract that says the worker can hire his own helper is insufficient to show independence. The worker must actually exercise the option and employ a helper or helpers to demonstrate independence. Further, the AI notes that "the 'control' factor should not play an oversized role in the analysis of whether a worker is an employee or an independent contractor. All possibly relevant factors should be considered."

Under the FLSA's economic realities test, only those workers who operate independent, as well as large-scale and successful businesses, are likely to qualify as independent contractors. The key factor that most independent workers will not be able to overcome is the "relative investment in the business" as compared to the employer, since few independent contractors have invested in their businesses to an extent that would come even close to the investment most employers have made into their much-larger businesses. Further, many business-models rely on contractors to perform work that is integral to the business—a factor that is fatal to this analysis. Thus, with the cards stacked against a finding of an independent contractor relationship, the AI's conclusion that "most workers are employees under the FLSA's broad

definitions" is accurate. And it is only a matter of time before courts (and state legislatures) start adopting the economic realities test in areas outside of the FLSA.

Motor Carriers under the New Labor Paradigm

The independent contractor distinction has special, historical significance for the motor carrier industry. For many years, and especially since the increased competitive environment created by de-regulations of our nation's trucking companies in the late 1990s, the trucking industry has relied upon "owner-operators" (i.e., individuals who own their own truck and lease their truck and their services as a driver to trucking companies). The reasons for this are mainly economic ones: since the cost of motor carrier equipment is significant, trucking companies can expand or retract their capacity requirements quickly and without adding significant capital costs by contracting with owner-operators to deliver freight.

This practice has made the nation's motor carrier industry much more competitive (both inter and intra-modally) as well as more flexible to market demand, since the carriers are freed from the necessity of increasing or decreasing work force and capital equipment demand on short notice. The economics of the relationship between owner-operators and trucking companies is largely based upon the ability of motor carrier to treat owner-operators as independent contractors as opposed to employees.

The reasons for this distinction in the motor carrier industry have been historically viewed with respect by courts and administrative agencies. Owner-operators typically meet the historical common law test for independence in that owner-operators own (or lease) their own "tools" (i.e., the truck); bring their own tools to the job; are free to work for multiple carriers simultaneously; are free to hire their own drivers and helpers; and are not required to accept dispatch or carry their own liability insurance and workers' compensation insurance (or its equivalent).

Unfortunately, however, due to public safety needs, certain federal regulations imposed upon motor carriers have been misinterpreted by some courts and agencies as evidence of a level of "control" sufficient to destroy the independent contractor status for owner-operators. For example, by law, motor carriers must have "control" over all trucks operating under load pursuant to their operating authority, and motor carriers must be responsible to the public for all operations conducted pursuant to their licensed operating authority. While this "control" requirement is limited strictly only to those specific points in time when the truck is operating under load for the carrier, some courts and agencies have mistakenly expanded their definition of "control" during this limited period as a basis to deny the characterization of owner-operators as true independent contractors. If owner-operators bring their own equipment to the relationship, are free to accept or decline work, may hire their own drivers or helpers, and perform services to multiple carriers during any given period of time when under contract with a carrier, then the owner-operator is no different from the "classic" independent contractor—the plumber—who can refuse the job, bring tools to the job, can set hours of work and can work for multiple customers.

While this analysis might hold true under the common law "right to control" test that remains in place in most states for purposes of workers' compensation, discrimination and taxation issues, it most likely will not pass muster under the FLSA's economic realities test as described in the AI. Under the AI, most of the factors of the economic realities test will favor an employment relationship for any owner-operator who owns or leases a single truck:

1) **Integral.** Owner-operators driving for a motor carrier are hauling freight, which is obviously integral to the business of a motor carrier.

2) **Opportunity for Profit/Loss.** Owner-operators who do not own/lease multiple trucks will not have the opportunity to realize greater profits, nor face the risk of loss. Simply driving more hours is insufficient to meet this factor.

3) **Relative Investment.** Owner-operators who do not own/lease multiple trucks will not have as significant of an investment in their business as the motor carrier itself will, even considering that a fully-outfitted truck can run in the hundreds of thousands of dollars.

4) **Business Skill and Initiative.** Owner-operators who own a single truck may not be able to demonstrate significant business decision-making to satisfy this factor. Those who advertise, lease space, make judgments on the best motor carriers to drive for, and employ other drivers and helpers are likely to meet this criteria.

5) **Permanence of the Relationship.** Owner-operators who continually drive for the same motor carrier will not satisfy this criterion, regardless of their level of independence and their business acumen.

6) **Degree of Control Exercised by Employer.** Owner-operators must be in control of meaningful aspects of their work, such that they are operating an independent business. Owner-operators must actually exercise this

control—so it is insufficient if they drive for a motor carrier that allows them to drive for other carriers and hire their own drivers or helpers. Owner-operators must actually drive for other carriers and employ drivers/helpers in order to satisfy this factor.

In light of this analysis, the best possible way for a motor carrier to insulate itself against a challenge under the FLSA's economic realities test is to, whenever possible, use fleet owners with several (more than one) drivers, and ensure that the fleet owner's drivers are W-2 employees and not 1099 independent contractors. The fleet owner can be an independent contractor as to you, the motor carrier, but its drivers must be its employees. While a motor carrier could still face a challenge that it is a joint employer over the drivers employed by the fleet owner, this risk is much lower than the risk of a finding that the carrier's independent owner-operators are actually its employees.

In addition to contracting only with fleet owners and owner-operators who own/lease more than one truck, motor carriers can also take the following steps:

1) Encourage all owner-operators to also haul for other carriers while under contract with you. Owner-operators' ability to show that they hauled for other motor carriers while under contract with you is critical to demonstrating independence.

2) Do not give any clothing or accessories to an owner-operator that has your company name or logo on it—not even the gift of a cap!

3) If you have a subsidiary company that leases trucks to owner-operators, the equipment lease **must** be completely independent from the independent contractor agreement with your operating company. For example, you cannot make the equipment lease terminable if the independent contractor agreement is cancelled with your operating company. As long as owner-operators make the lease payments, they keep the equipment—even if they are now hauling for your competitor.

4) If you lease Qualcomm or similar GPS/communication equipment to owner-operators, be certain that they understand they have a choice to buy or lease that equipment from someone else (as long as it meets reasonable specifications and is compatible with your satellite system).

5) Always let owner-operators choose their own routes. Pay by percentage of haul only (not by mileage).

6) Never force dispatch—they must have the right to reject loads (for **any** reason). And remember, your written policy against forced dispatch must be in place in actual practice. There can be no "unspoken rule" that turning down a load will remove an owner-operator from the call list.

7) Never tell owner-operators that their contracts will be terminated if they do not accept any certain volume or number of loads. Again, written policy and actual practice must match.

8) Whenever possible use a third party provider to provide training. You can train with regard to your specific company operations, but you should never provide training directly on general truck driving skills or methods. Allow owner-operators to schedule company-specific training at their convenience, not yours.

Despite these practices, motor carriers will continue to face legal challenges to their long-standing and sensible business model. A vast number of products move by truck, and many, if not most, trucking companies utilize independently contracted owner-operators. Efforts to attack and destroy this historical relationship in the motor carrier industry, if successful, will substantially increase the cost of transportation of our nation's goods; which cost will ultimately have to be borne by consumers.

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