

Chapter 3

Coverage of the FLSA

The FLSA contains several provisions defining the coverage of the Act based upon both:

- the nature of the employer
- and
- the type of work the employee performs.

An employee can be covered by the Act either because the employer for whom the employee works is a covered “enterprise” **or** because the employee is engaged in interstate commerce (which, as noted below, is just about everyone in today’s world).

Definition of employer

An employer is covered by the FLSA if it fits within the Act’s definitions of a covered “enterprise” that is “engaged in interstate commerce.”

Covered enterprise

An enterprise is defined as an individual, corporation, school, university, government agency or healthcare institution engaged in interstate commerce that directly or indirectly employs workers and that has an annual gross volume of sales made or business done of not less than \$500,000. (The dollar volume test, however, does not apply to health care institutions, schools, universities and government agencies, which are covered by the Act if engaged in interstate commerce regardless of their volume of business.)

Engaged in interstate commerce

The Act’s interpretation of “engaged in interstate commerce,” including any enterprise that “has employees engaged in commerce or in the production of goods for commerce, or that has employees handling, selling, or otherwise working on goods that have been moved in or produced for commerce by any person.” This definition is incredibly broad and very few types of businesses will avoid coverage of the FLSA based upon the breadth of this definition.

Personal liability

The FLSA's definition of "enterprise" includes individuals as well as businesses. Therefore, an individual owner or employee of a business may be held personally liable for the company's violations of the FLSA if the employee is at least partly responsible for the violation. For an individual employee to be held liable for the employer's FLSA violations, however, the employee must be a corporate officer who controls the operations of the business and thus determines how its employees will be compensated.

Definition of employee

An employee of a company that is not a covered enterprise under the FLSA may still be protected by the Act's minimum wage, overtime pay, and child labor provisions if he or she is engaged in interstate commerce or in the production of goods for interstate commerce, or in any closely-related process or occupation directly essential to such production. These employees include those who do one or more of the following:

- work in communications or transportation
- regularly use the mails, telephones, or telegraph for interstate communication (based on developments in communications technology, an employee who regularly uses a fax machine or the Internet for interstate communications is likely also covered)
- keep records of interstate transactions
- handle, ship, or receive goods transported through interstate commerce
- regularly travel interstate in the course of their employment
- work for employers that contract to do clerical, custodial, maintenance, or other work for firms engaged in interstate commerce or the production of goods for interstate commerce.

The fact that the terms "engaged in interstate commerce" are construed broadly cannot be overstated. If your business takes the position that an employee is not engaged in interstate commerce, you can expect the Wage and Hour Division of the United States Department of Labor (DOL) to make strong efforts to show otherwise and the Department has usually been successful in litigation over this issue. Therefore, before relying on this legal basis for not complying with the FLSA, you should consult with experienced legal counsel.

Geographic limitation

The FLSA does not apply outside of the United States. Therefore, citizens of the United States are not covered by the minimum wage, overtime, and child labor provisions of the FLSA while they are outside of the United States or its territories. Certain special

minimum wage provisions apply to United States citizens residing in certain U.S. territories, such as the Northern Mariana islands and American Samoa.

Who is an employee

The concept of an employee is broadly defined by the FLSA. It is critical to understand at the outset that how a business and a worker view their relationship is not controlling. For example, many businesses rely on independent contractors who, in reality, are employees for FLSA purposes. The same is true for “volunteers.” If a business improperly treats a worker as an independent contractor or volunteer, the company has created a substantial risk of liability under the FLSA even if the worker also views himself or herself as an independent contractor or volunteer. Accordingly, it is very important that a business consider whether an individual’s proposed role with the business will likely qualify as an independent contractor or volunteer **before** the relationship begins.

Independent contractor under the FLSA

The status of an individual as an independent contractor or an employee is not determined by the name, label or designation in a contract or verbal arrangement, but by the “economic realities” reflected in the particular relationship. Under the FLSA, an individual is an independent contractor if he or she renders services in the course of an independent occupation and is subject to the will of his or her client only as to the result of the work and not as to the means by which it is accomplished. There is no “black-and-white test” or rule that establishes whether an individual qualifies as an independent contractor. Instead, one must analyze various facets of the proposed or actual relationship to determine whether the economic realities of the relationship, when considered in their totality, support a finding of an independent contractor relationship or employer-employee relationship.

Economic realities test

The DOL and many courts determine whether an individual is an employee or independent contractor of an employer by looking at the “economic realities” of the arrangement. The determination is not dependent simply upon whether the work performed provides the worker with his or her primary source of income. The issue is whether the individual is dependent upon the employer’s business as a means of livelihood or as a matter of “economic reality.” No single factor is more important than another: courts consider the entire circumstances of the working relationship.

When evaluating whether an individual is an employee or an independent contractor, the DOL and courts will consider the following facts to help determine the “economic realities” of the situation. These factors are discussed more fully below with respect to the IRS’ economic realities test.

- right to control
- opportunity for profit and loss
- duration of relationship

- significance of work
- skill, judgment, or foresight
- substantial investment or cost by person performing the service.

IRS economic realities test

The DOL and courts frequently apply the Internal Revenue Service's (IRS) approach to determining whether an individual is an independent contractor or employee. For decades, the IRS used what is still called the "20-Factor Test" which, as the name suggests, consists of 20 factors to consider when making this determination. More recently, however, the IRS has moved away from the somewhat-rigid 20-Factor Test in favor of an economic realities test that considers the following three broad facets of the relationship:

1. **Behavioral control** – does the company control or have the right to control what the worker does and how the worker does his or her job?
2. **Financial control** – are the business aspects of the worker's job controlled by the company/payer (in other words, how is the worker paid, are expenses reimbursed, and who provides tools and supplies)?
3. **Type of relationship** – are there written agreements governing the relationship and does the company/payer provide benefits other than payment for services provided)?

Businesses should consider and weigh all of these factors when determining whether an individual can properly be classified as an independent contractor. No one factor is controlling and factors that may be relevant in one situation may not be relevant in another. Set forth below is the IRS' summary of the Behavioral Control, Financial Control, and Type of Relationship factors.

Behavioral control

The behavioral control factors fall into the following categories:

- **Type of instructions given** – An employee is generally subject to the business' instructions/control about when, where, and how to work. Following are examples of types of instructions about "how to work:"
 - when and where to do the work
 - what tools or equipment to use
 - what workers to hire to assist with the work
 - where to purchase supplies and services

- what work must be performed by a specified individual
 - what order or sequence to follow when performing the work.
- **Degree of instruction** – The more detailed the instructions, the more control the business exercises over the worker. In turn, the more control exercised by the business makes it more likely that the worker is an employee and not an independent contractor. Even if no instruction is actually given, this factor may still support an employee finding if the business has retained the right to control the work even if the company does not exercise that right.
 - **Evaluation system** – If an evaluation system measures the details of how the work is performed, this factor supports a finding of an employee-employer relationship. On the other hand, if the evaluation system only measures the end result, this factor can support a finding of an independent contractor.
 - **Training** – If a business provides training to the worker on how to perform the job, this fact supports a finding of an employee-employer relationship. In fact, the IRS has indicated that this factor is strong evidence of an employer-employee relationship because it shows that the business wants the job done in a certain way. Because independent contractors ordinarily use his or her own methods to obtain an end result, such training is inconsistent with an independent contractor relationship.

Financial control

This test refers to facts that show whether the business has the right to control the economic aspects of the worker's job and falls into the following categories:

- **Significant investment** – An independent contractor often has made a significant investment in the equipment he or she uses to perform work for someone else. This fact can sometimes support a finding of an independent contractor relationship but not always. For example, construction workers frequently use their own tools on the job but, in many cases, they remain employees. In short, this factor can be helpful in some cases but neither its presence nor its absence is a clear indicator of the proper relationship in most situations.
- **Unreimbursed expenses** – Independent contractors are more likely to have unreimbursed expenses than are employees.
- **Opportunity for profit or loss** – The opportunity for the worker to make a profit or loss (or the absence of such) is an important factor. An individual's possibility of incurring a loss on a project (due to higher-than-expected costs for performing the work which are not reimbursed) indicates an independent contractor.
- **Services available to the market** – An independent contractor is generally free to seek out business opportunities outside of the business. Examples of this

include advertisements by the worker and work performed for other businesses.

- **Method of payment** – An employee is generally guaranteed a regular amount for an hourly, weekly, or other period of time. An independent contractor is usually paid a flat fee for the project or job.

Type of relationship

The type of relationship refers to factors that show how the worker and business perceive their relationship. Again, such perception is not ultimately controlling but it is a factor that is considered. This analysis of the type of relationship between the parties generally considers the following factors:

- **Written agreements** – The parties' own agreement and how it defines the relationship will be considered but will not control the determination of the relationship. An independent contractor and a business to whom he or she is providing services will normally execute an agreement that governs the terms of the relationship including a reference to the fact that no employment relationship is created. However, regardless of what the agreement says, courts and the DOL (as well as the IRS) will put more weight on the realities of the working relationship than the terms of a written agreement.
- **Employee benefits** – Businesses generally do not offer employee benefits, such as insurance, vacation, retirement plans, sick days, and disability insurance, to independent contractors. Accordingly, the presence of such benefits will support a finding of an employer-employee relationship. The converse is not necessarily true. Many businesses do not offer such benefits to its employees--therefore, the mere absence of such benefits will not necessarily support a finding of an independent contractor relationship.
- **Permanency of the relationship** – If a business “hires” a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence of an employer-employee relationship.
- **Services provided as a key activity of the business** – If a worker provides a **service** that is a key or essential aspect of the business, it is more likely that the business will have the right to direct and control how the service is provided and the worker's activities. This will normally support a finding of an employer-employee relationship.

Volunteerism under the FLSA

A question that frequently arises in the field of wage and hour law is, “when can an individual volunteer his or her services?” This is also an area of the law that is frequently misunderstood and/or misapplied. In 1985, Congress amended the FLSA to specifically address volunteers. Pursuant to these amendments, an individual will generally be considered a volunteer if he or she:

- performs service for a public agency for civic, charitable, or humanitarian reasons, without promise, expectation, or receipt of compensation for such services (although a volunteer can be paid expenses, reasonable fees, or a nominal fee to perform such services)
 - offers his or her services freely without pressure or coercion
- and
- is not otherwise employed by the same public agency to perform the same type of services as those for which the individual proposes to volunteer.

Although the 1985 amendments to FLSA mentions only “public agencies,” the DOL has applied the same tests to non-profit organizations in opinion letters issued by the agency. For example, in a 2005 opinion letter, the DOL addressed the application of the FLSA to employees of a non-profit university who volunteered their time at an annual event hosted by the school. The DOL noted that the university must compensate the employee/volunteers for any time spent volunteering during their normal working hours and for any time spent performing duties that are similar to their normal duties (even if outside their normal working hours). However, the DOL opined that no compensation was required when the volunteer activities occurred outside the employees’ normal working hours and did not entail duties that were not similar to the employees’/volunteers’ normal working duties. Keep in mind, however, that opinion letters issued by the DOL are not binding precedent. However, courts have, for the most part, also upheld volunteer relationships at non-profit organizations (as opposed to just public agencies) where the other required factors are also present.

For-profit organizations should consider carefully any situations where employees “volunteer” their time to any activity or function that could potentially be seen as benefiting the organization. For example, if a for-profit hospital operates a health fair where residents of the community can obtain free health screenings and other basic care, it is unlikely that the DOL would deem workers at the health fair as volunteers. Even though the hospital is not receiving compensation for the health fair, it is likely receiving favorable public relation or marketing results from the “good deed.” Whether one agrees with this result or not, the safest approach for a for-profit organization is simply to avoid the use of “volunteers,” especially where the employer is the main sponsor of the charitable event and the event or activity is similar to the employer's primary business.

Joint employers

In some circumstances, the FLSA requires that an individual be considered an employee of two employers at the same time. In such instances, the question arises whether the employers are joint employers of the employee or separate and distinct employers who operate independently.

The “joint employment” concept under the FLSA has at least two important implications. First, it determines whether an entity must be considered an employer of a shared worker. Under the FLSA, joint employers are responsible, both individually and jointly, for compliance with all of the applicable provisions of the FLSA, including its overtime pay provisions, with respect to the entire employment of a shared employee. Second, the “joint employer” concept governs when an employee’s time spent working for two different entities must be combined for purposes of computing overtime liability.

Under the FLSA, a joint employment relationship will exist where:

- there is an arrangement between employers to share an employee’s services

or

- to interchange employees

or

- one employer acts directly or indirectly in the interest of the other employer in relation to the employee

or

- the employers are not completely disassociated with respect to the employee’s employment and may be deemed to share control of the employee, directly or indirectly, because one employer controls, is controlled by, or is under common control with the other employer.

Leased employees

Based on these three criteria, an entity that engages the services of temporary or leased workers will be considered a joint employer with the temporary agency or leasing company that provides these employees to the employer. Therefore, if a temporary employee works in excess of 40 hours in any work week for any one establishment, that employer would be jointly responsible with the temporary agency for the proper payment of overtime compensation as well as the minimum wage for all hours worked to the employee.

Because the temporary agency and the contracting company are considered joint employers of leased employees, both companies have independent liability under the FLSA with respect to those workers. This fact places companies that use temporary or leased employees in a difficult position because once the company has paid the agency for the employees’ service, it has no way of knowing whether the agency is complying with the FLSA (or applicable state law) when it issues the employees’ paychecks. For example, if the agency charges the contracting company for overtime worked by the leased employees, but then fails to pay the collected money to the employees, the contracting employer would still be liable under the FLSA for the unpaid overtime.

Affiliated employers

The regulations implementing the FLSA provide that a corporation will be held jointly liable for an affiliate’s failure to pay minimum wages or overtime when the corporation is “not completely

disassociated” from the employment of the affiliate’s employees and the affiliate is in some way “controlled by” the corporation or a common parent corporation.

Under most federal laws, courts look to the following four factors to determine whether two companies are “integrated enterprises” for purposes of imposing joint liability:

1. interrelated operations
2. common management, common directors and boards
3. centralized control of labor relations and personnel management
4. common ownership or financial control.

When applying this test, however, courts do not require that each of these four factors be present to find joint liability. Instead, the courts balance the extent to which the factors are present in each case to assess the degree of interrelationship between the two companies.

Based on the more specific guidance that the FLSA regulations provide, however, courts using this four-factored test in determining the joint liability of affiliated companies will emphasize the degree of association between the two companies in determining whether joint liability is appropriate. Therefore, the factor of “interrelated operations” assumes greatest significance. “Interrelated operations” will often be found under the FLSA where the affiliated companies share a common workspace or maintain joint records, bank accounts, or equipment.

At the same time, courts have often de-emphasized the importance of “centralized control of labor relations” in assessing whether affiliates are jointly liable under the FLSA based on its omission from the factors cited in the FLSA regulations. Therefore, in analyzing whether affiliates are “not completely disassociated,” courts have found sufficient centralization of control where one company administers the personnel or payroll policies of the other company, or where there are close communications between the two employers with regard to labor relation issues. As a result, courts will often find joint liability under the FLSA in situations where one corporation is so closely related to an affiliated corporation that it has the ability to control that affiliate’s compensation of employees, even if the corporation never actually uses that control to supervise the affiliate’s compensation practices. Therefore, closely affiliated corporations should take active measures to ensure that all of their affiliates’ employees are properly compensated under the FLSA.