We write this article to inform SIOP members interested in the Fair Labor Standards Act (FLSA) and in employee protections in general of important proposed changes to this law by the Department of Labor as a result of a directive from President Obama “to modernize and streamline” the FLSA regulations. Should these changes be put in place, the number of employees covered under this law will expand by millions of new nonexempt employees. Other important changes are a result of the Department of Labor’s cooperation with the IRS to crack down on misclassified independent contractors and the treatment of expert testimony involving sampling and statistical evidence in wage and hour class actions. The ramifications of such pivotal changes are extensive and will have immediate and dramatic effects on organizations when and where these changes take effect.

Three primary changes have been proposed: (a) changes to FLSA overtime exemption criteria, (b) increased enforcement of the independent contractor misclassification, and (c) increased scrutiny regarding the use of sampling and statistical evidence in wage and hour class actions. We discuss these changes and anticipated consequences below.

Changes to FLSA Overtime Exemption Criteria

In July 2015, the U.S. Department of Labor (DOL) released a much-anticipated proposal to revise federal regulations that define which employees are “exempt” from FLSA protections. The DOL proposal was in response to a 2014 directive from President Obama to “modernize and streamline” the FLSA regulations (see Executive Office of the President, 2014). The directive was widely publicized at the time (e.g., Shear & Greenhouse, 2014) and intended to address the concern that current regulations have “failed to keep up with inflation, only being updated twice in the last 40 years and leaving millions of low-paid, salaried workers without these basic [FLSA] protections” (Office of the Press Secretary, 2014).
Hourly employees enjoy protections regarding pay and working conditions under the FLSA, and the proposed revisions, if adopted, will expand the number of employees covered potentially by millions by raising the bar on who qualifies as “exempt” from the FLSA. The regulations delineate a set of exemption criteria, two of which concern how much an employee is paid per week (“salary test”) and how much time an employee spends performing exempt work (“job duties test”). Prior to President Obama’s directive, employees were considered “exempt” from the FLSA and therefore not covered by the FLSA if they made at least $455/week and if their primary duty was exempt work (see 29 C.F.R. § 541 et seq.). An evaluation of “primary duty” requires an understanding of what work employees actually perform, the context in which it’s performed, the nature of the work, and the time spent on that work. Job analyses are often required to collect this evidence (Banks & Aubry, 2005; Banks & Cohen, 2005; Hanvey & Banks, 2015; Honorable, Wyld, & Juban, 2005; Ko & Kliener, 2005). In California, primary duty is interpreted as spending more than 50% of one’s work week performing exempt work.

Proposed Changes

The DOL’s Notice of Proposed Rulemaking (NPRM) adjusts the current minimum salary requirement for exemption from $455/week ($23,660/year) to the 40th percentile of weekly earnings which is $951/week ($49,452/year) based on 2015 data, but it may be higher if there is wage growth in 2016 when the change takes effect (U.S. Department of Labor, 2015b). If adopted, this increase in the salary test will disqualify all employees now earning between $23,660 and $49,452 per year, forcing employers to reclassify those employees as nonexempt. The FLSA also currently exempts “highly compensated” workers who earn $100,000 or more in total compensation. The proposed new rules set the new threshold at the 90th percentile of weekly earnings for full-time salaried workers, which would increase this threshold to $122,148. It is estimated that these changes will impact millions of employees.

Second, the NPRM requested feedback on whether and how the job duties test should be changed. Although no official change was proposed, the DOL is considering whether a quantitative threshold for time spent performing exempt work should be adopted as is the case in California. Such a quantitative threshold is considered a more stringent test than the one that currently exists in the regulations. If a 50% threshold is adopted, more employees are likely to lose their exempt status even if the salary test is met.

Impact on employers. The DOL estimates that the aggregate direct costs for organizations as a result of the proposed changes will be between $239M and $255M per year, which includes costs related to “regulatory familiarization, adjustment costs, and managerial costs” (Department of Labor, 2015b). Reclassification of salaried (exempt) employees to hourly (nonexempt) employees involves multiple changes within an organization: (a) changes in the way compensation is computed and administered, (b) adjustments to work
schedules to limit the amount of time reclassified employees spend at work, (c) training reclassified employees to record their time worked including overtime, (4) implementation of a meal and rest break schedule for reclassified employees if they are required to take breaks in their state or according to policy, and (5) potential increases in staffing if switching reclassified employees to 40-hour weeks is insufficient to cover work demand. Reclassification also may increase the organization’s risk of lawsuits associated with various wage and hour violations for nonexempt hourly employees (e.g., off-the-clock work, missed meal and rest breaks; improper compensation). In short, available labor will be less and complications associated with properly administering requirements under the FLSA as well as state laws will be more.

Impact on employees. Reclassification will likely result in meaningful changes from the employee’s perspective as well: (a) number of hours worked per week, (b) decreased pay due to a smaller number of hours worked, (c) changes to job responsibilities, (d) new timekeeping requirements, (e) new policy requirements (e.g., meal and rest breaks), and (f) perceived decrease in status. Perhaps most troubling to reclassified employees is the loss of prestige associated with exempt status; many reclassified employees perceive this change as a demotion.

Independent Contractors

Many companies have business models that include the retention of independent contractors. Independent contractors are, by definition, self-employed workers who are paid for the services they provide the company. The independent contractor relationship differs in important ways from an employee relationship, most notably different tax obligations and entitlements to wage and hour protections such as minimum wage and overtime. The primary benefit to employers by using independent contractors is reducing payroll costs. Multiple federal agencies such as the DOL and Internal Revenue Service (IRS) have published separate guidance on how to determine the proper status (Joerg, 1996). Although there is no definitive list of factors that determine independent contractor status in all situations, generally the guidance relates to whether the worker is economically dependent on the employer or truly in business for themselves (known as the “economic realities” test) and the degree of control the employer has over the worker. An agreement between the employer and a worker labeling the worker as an independent contractor is not considered relevant to the analysis of the worker’s correct status. Job analysis methods that document how a person performs his or her job and the degree and nature of contact between the person and client company employees could provide evidence that can address these factors.

As part of the recent misclassification initiative, the DOL publicly stated that it intends to increase efforts to identify misclassified independent contractors (e.g., U.S. Department of Labor, 2010) and has entered into a Memorandum of Understanding with the IRS and state agencies to share information and coordinate
enforcement efforts to identify employers that have misclassified employees as independent contractors (U.S. Department of Labor, n.d.). In July, the DOL released a document, Administrator’s Interpretation No. 2015-1, which broadens the definition of “employment” in order to reduce the number of workers improperly classified as independent contractors (U.S. Department of Labor, 2015a). The factors comprising the “economic realities” test and discussed in this document are the following: (a) Is the work performed an integral part of the employer’s business? (b) Does the worker’s managerial skill affect the worker’s opportunity for profit or loss? (c) How does the worker’s relative investment compare to the employer’s investment? (d) Does the work performed require special skill and initiative? (e) Is the relationship between the worker and the employer permanent or indefinite? (f) What is the nature and degree of the employer’s control? All of these factors are evaluated independently and are considered in light of the ultimate determination of whether the worker is really in business for him or herself or is economically dependent on the employer.

The most closely watched independent contractor case is *O’Connor v. Uber Technologies, Inc.* In September, a district court judge certified a class of 160,000 California Uber drivers who claim they were misclassified as independent contractors. Class certification is only the first step toward resolution of this case; the next phase will determine whether Uber drivers are truly independent contractors. This case comes after the California Labor Commissioner ruled in June that an Uber driver was an employee and not an independent contractor (*Uber Technologies, Inc. vs Berwick*). The case is set to go to trial in June 2016.

**Impact on employers.** With increased scrutiny, employers will need to review all of dealings with independent contractors to ensure they are in safe territory. In particular, analyzing the extent to which independent contractors are interacting with client company employees would be of primary importance as the employer has to show worker independence and self-control over job details. Moreover, they need to show evidence that independent contractors do not perform work that is integral to business operations and that they perform work that is qualitatively different from regular employees. Also, agreements with independent contractors should show evidence of that independence and impermanence. These implications strongly suggest that employers should reserve independent contractor status for job duties that are specialized, different from those of employees, performed independently, and not part of the employer’s general business operations.

A finding that independent contractors are in fact employees greatly increases the employer’s labor costs. The employer could be on the hook for all employee-related costs including payroll taxes, benefits, workers compensation, unemployment, overtime, and state labor code requirements. Potentially more damaging is the employer’s need to rethink their business model that factors in lower labor costs by retaining independent contrac-
Revised business models incorporating the true cost of labor to perform the necessary business operations may make some businesses less competitive or lower their competitive advantage in the marketplace and level the playing field for those who do not use independent contractors.

**Impact on independent contractors.** The increased scrutiny may force independent contractors to bolster their economic independence from client companies by broadening their client base and by taking on more personnel functions for their employees who perform work for clients. They may choose to step up their role as employers to their own staff to increase their perceived and actual level of independence from clients. Single individuals serving as independent contractors who want to maintain this status may also change the nature of the relationship with the client to one that is more independent, such as no longer working at the client site, paying for own work-related expenses, incorporating as a sole proprietor, invoicing the client on a regular basis, and securing multiple clients.

**Implications for the sharing economy.** The “sharing economy” is defined as an economic model in which individuals are able to borrow or rent assets owned by someone else (Investopedia.com). *The Economist* defines it as a peer-to-peer-based sharing of access to goods and services (*The Economist*, 2013). When the assets borrowed or rented are a person’s labor, we venture into DOL and IRS regulated space. When does a person operating in the sharing economy become an independent contractor? The lines are blurred but caution should be exercised when labor “rented” looks the same as labor “bought” through employment. Regulation is undoubtedly going to continue in this economic space because of the financial implications for governments and business competitors.

**Sampling and Statistics**

Sampling and statistics often play a central role in wage and hour cases because the vast majority are brought as class actions. Because it is rarely feasible to collect data from an entire class, sampling is necessary. To certify a class, plaintiffs must demonstrate that the claims of individual class members are similar enough to be resolved on a class-wide basis and that the class action will be manageable if it proceeds to trial (as opposed to hundreds of “mini-trials”). Plaintiffs often point to uniform policies to meet the first criterion and propose a strategy for collecting data from a sample of class members and extrapolating the results to the rest of the class to meet the second criterion. Defendants argue that the variability among class members is too great for issues to be resolved on a class-wide basis. Two recent cases tested the appropriateness of sampling in a class action.

*Tyson Foods Inc. v. Bouaphakeo* is currently pending before the U.S. Supreme Court. *Tyson* involves a claim that the company failed to pay workers at an Iowa pork-processing plant for time spent putting on and taking off protective gear (“donning and doffing”). The class was certified, and the defendant was found to be liable for $5.8 million dollars. This verdict was upheld by
The 8th Circuit and now awaits judgment by the U.S. Supreme Court. The central issue now is whether it was appropriate to use the calculated average amount of time employees spent donning and doffing from a sample of class members to certify the class and to determine damages. Defendant argued that the degree of variability among class members was sufficient to make the sample average inappropriate because it cannot be assumed that class members were identical to the average. Defendant noted that the actual amount of time spent per person ranges from 30 seconds to 10 minutes and that some employees did not suffer any damages. Plaintiffs argued that differences between class members were minimal.

Duran v. US Bank NA, an overtime case, was recently decided by the California Supreme Court. In Duran, the trial court adopted a trial plan that involved collecting testimony at trial from a random sample of 20 class members, and this sample would allow the court to determine whether all class members were exempt or nonexempt from overtime. Extrapolating sample results to the whole class is known as “trial by formula,” and this approach has been rejected by the U.S. Supreme Court in Dukes v. Wal-Mart. Nonetheless, this strategy was followed, and the court determined that, based on the testimony from this sample of class members, the entire class of 260 employees were misclassified and an award of $15 million was given to plaintiffs.

The California Supreme Court overturned the Duran verdict, stating that the trial plan was “profoundly flawed” in several ways: (a) the sample was too small, (b) the sample was not random, and (c) there was a high margin of error in the estimation of the class average of overtime. The sample was not random because four of the 20 class members selected to testify chose not to testify including two who were urged by plaintiffs’ counsel to withdraw from the case because the class members believed they were properly classified as exempt. The trial court also erred by not conducting an assessment of variability prior to certifying the class and ignoring individual issues.

Both Tyson and Duran directly address applicability of sampling in wage and hour class actions. The Duran decision now requires a more rigorous examination of variability among class members before a class is certified when sampling and statistics are included in the trial plan. The Tyson case focuses on the appropriateness of computed averages and margins of error in support of a class certification motion. An average, by definition, ignores the degree of individual variability and does not address the key question at this stage in litigation: Is the class sufficiently similar to be treated as a class? When variability is high, the average may be mathematically correct but also meaningless as a description of individual class members. This is most obvious when half of the class is misclassified and the other half is not. With such variability, a court cannot determine which nonsample class members are misclassified and which are not.

The takeaway here is that I-O psychologists working in this area need be aware of the relevant legal questions and design
sampling plans only when appropriate. It is likely that the *Tyson* case will provide additional guidance on these issues.

**Conclusion**

The wage and hour litigation world continues to evolve as businesses change strategies to lower costs and capitalize on competitive opportunities. Although not a traditional line of work for I-Os, wage and hour litigation offers new avenues of research and practice by posing questions ideally suited for I-Os to answer. Specifically, questions such as “What do workers actually do on the job and who do they interact with?” and “How much discretion and independence is exercised on the job?” are key to understanding the proper classification of workers. Similarly, what statistics to use in showing work-related evidence to the court is also key to the proper resolution of these lawsuits. This update is intended to not only inform those who follow this field within I-O but also to entice new entrants into this field.

**References**


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