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Jury must decide Arizona worker's misclassification claim

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Employers must consider many factors when making decisions regarding the growth of their business. Hiring employees can be expensive, but misclassifying employees as independent contractors will cost more in additional wages, taxes, and other potential liabilities down the road. In 2016, the Arizona Legislature enacted a statute to help clarify the independent contractor relationship for Arizona employers, A.R.S. § 23-1601. Unfortunately, many employers are unaware that the statute, if properly followed, provides an added layer of protection against potential liability—e.g., overtime liability for misclassification under the Fair Labor Standards Act (FLSA)

The express purpose of the FLSA is to encourage employers to hire additional employees by making it more expensive for employers to require current employees to work longer hours. To that end, the FLSA generally requires employers to pay a premium to employees who work more than 40 hours in a workweek. The rule does not apply if the employer is not a covered entity under the FLSA or if the worker is an independent contractor. A couple of Arizona property maintenance and management companies may learn firsthand that just answering the questions of whether an employee is misclassified and whether the FLSA applies can be costly.

A prelude to litigation

In May 2014, William Litzendorf began working as a handyman for Cluff Property Management, which manages residential rental properties. He signed an independent contractor agreement. Cluff uses Property Maintenance Solutions (PMS) to coordinate the maintenance needs of its properties. When Cluff needed maintenance work, it would notify PMS of the work opportunity. PMS would in turn send text messages to its maintenance workers, including Litzendorf, to accept the work on a first-come basis. Litzendorf would submit a work order to Cluff and would receive a weekly check for the services performed.

Litzendorf filed a complaint in the U.S. District Court for the District of Arizona against Cluff and PMS alleging that he (1) was an employee entitled to the protections of the FLSA, (2) regularly worked 50 to 60 hours per week, and (3) should have been paid overtime. Cluff and PMS argued that he was an independent contractor, and therefore, he was not entitled to overtime. The companies also argued that even if he was an employee, they are not covered entities subject to the FLSA's requirements. Both sides asked the court to enter judgment in their favor without a trial.

Employee or independent contractor?

Although employees are covered by the FLSA, independent contractors are not. So whether Cluff and PMS could be liable to Litzendorf for overtime turned on whether he was improperly classified as an independent contractor. The fact that he entered into an agreement labeling him an independent contractor was not determinative. Rather, courts use a variety of factors to determine whether a worker is a covered employee or an independent contractor:

1. The degree of the employer's right to control the manner in which the work is performed;
2. The worker's opportunity for profit or loss;
3. The worker's investment in equipment or materials or the employment of helpers;
4. Whether the service requires special skill;

5. The degree of permanence in the working relationship; and
6. Whether the service is an integral part of the employer's business.

Factual disputes prevented the court from making a determination on the issue. The parties disputed whether Litzendorf was permitted to assign work to other workers, whether he was prohibited from performing maintenance and repair work for other companies, and whether he was required to provide his own truck and tools.

Did the FLSA provide coverage?

To be subject to the FLSA's overtime rules, an employee must (1) be engaged in commerce or the production of goods for commerce (individual coverage) or (2) be employed by an enterprise engaged in commerce (enterprise coverage). Commerce requires trade, transportation, transmission, or communication across state lines. For enterprise coverage, a company's annual sales or business must be at least $500,000.

Courts have broadly interpreted what it means to be engaged in interstate commerce, so individual coverage will apply more often than not. Courts have found that workers performing security or maintenance work for a business engaged in interstate commerce are engaged in interstate commerce themselves. There is no requirement that workers' engagement in interstate commerce be substantial. Litzendorf sometimes purchased materials necessary to complete his tasks from Home Depot, but the frequency with which he did so (i.e., regular activity versus sporadic activity) was not clear. The factual dispute requires a jury to decide whether he handled goods that traveled in interstate commerce, thereby potentially creating individual coverage.

Next, the court analyzed whether enterprise coverage existed. Individually, neither Cluff nor PMS makes more than $500,000 per year. Collectively, they do make more than that amount. For enterprise coverage to exist, the companies had to constitute a single enterprise, which is determined by related activities, unified operations or common control, and common business purpose. Again, the court punted the issue to a jury because the parties disputed whether the maintenance and management of the properties were sufficiently similar, whether the companies shared a common business purpose and control over Litzendorf's work, and whether either company could terminate the agreement.

Barring a settlement, a jury will have to decide whether Litzendorf was an employee and, if so, whether the FLSA's overtime rules applied under the circumstances. If those issues are decided in the affirmative, the jury will have to wade through conflicting evidence regarding the hours allegedly worked by Litzendorf to determine what amount, if any, he is owed for back overtime wages.

What preventive measures are available?

As mentioned earlier, Arizona companies now have a statutory tool that allows them to establish that their relationships are independent contractor relationships. That can be done by executing declarations, within the statutory parameters, affirming that the relationship is based on independent contractor status, not an employer-employee relationship.

The effects of the declaration are two-fold. First, the declaration allows the business and independent contractor to analyze the specifics of their relationship under factors that are similar to the factors outlined above. In doing so, they can determine whether the relationship actually fits within the independent contractor criteria or whether the worker should be hired as an employee. Second, it creates a rebuttable presumption—a safe harbor, if you will—that the worker is properly classified as an independent contractor. If a dispute arises later, the worker will have to overcome the presumption by showing that the business did not act in a manner consistent with the declaration.

Takeaway

Businesses need to analyze whether their workers are properly classified as independent contractors or employees. Also, this case highlights the importance of creating a clear separation between business entities. The overlap of ownership and management of Cluff and PMS (which is too complex to get into for purposes of this article) could result in enterprise coverage and subject the businesses to liability under the FLSA, depending

on the outcome of the independent contractor classification evaluation. It is important to consult with legal counsel regarding classification questions or potential joint-employer issues since those inquiries are highly factual and errors could be costly.

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