IN THIS MONTH'S column, we report on a recent decision of the U.S. Court of Appeals for the Second Circuit, in which the court clarified the standard for determining whether contractors and their principals are “joint employers” within the meaning of the Fair Labor and Standards Act of 1938 (FLSA).

‘Ling v. Liberty Apparel’

In Ling, et al. v. Liberty Apparel Co., the Second Circuit, in an opinion written by Judge Jose Cabranes and joined by Judges Ralph Winter and Pierre Leval, vacated and remanded a district court decision that had narrowly construed the meaning of “joint employers” under the FLSA and granted summary judgment to certain defendants.

Plaintiffs were 26 non-English-speaking adult garment workers who worked in the Chinatown section of Manhattan. Alleging violations of the FLSA and its New York statutory analogs, plaintiffs brought an action against (1) their immediate employers, who were contractors in the building where they worked and (2) Liberty Apparel Co. Inc. and its principals (Liberty). Because the contractor defendants could not be located or had ceased doing business, plaintiffs voluntarily dismissed their claims against those defendants, with prejudice.

Liberty is a “manufacturing company that contracts out the last phase of its production process.” That process worked as follows: Liberty developed patterns for garments, cut a sample for the pattern and sent the samples to customers for approval. Once the patterns were approved, Liberty purchased fabric necessary for production and its employees cut the fabric, which was then sent to contractors for assembly. The contractors, in turn, employed workers, including plaintiffs, to stitch and finish the pieces, paying them a piece rate for their labor.

From March 1997 to April 1999, Liberty entered into agreements with the contractors whereby the contractors assembled garments according to Liberty's specifications. Plaintiffs claimed that 70 to 75 percent of their work during this time period was performed for Liberty, whereas Liberty claimed that only 10 to 15 percent of their work was performed for the company. In addition, plaintiffs claimed that Liberty representatives visited their factory two to four times per week for up to three hours to inspect the finished garments, provide instructions directly to the workers and urge them to work harder. Liberty asserted that its representatives only made brief visits to plaintiffs' factory and spoke with the contractors and not to the workers directly. Plaintiffs brought an action against the contractors and Liberty, alleging, among other things, that they had not received minimum wages or overtime pay as required by the FLSA and various New York statutes. Liberty moved for summary judgment on the ground that it did not “employ” plaintiffs within the meaning of the FLSA.

Relying on the Second Circuit's decision in Carter v. Dutchess Community College, the district court examined the “economic reality” of the relationships between plaintiffs and Liberty and granted Liberty's motion for summary judgment. The district court analyzed four factors to reach its conclusion: “whether the alleged employer (1) had the power to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of payment, and (4) maintained employment records.” The district court determined that plaintiffs were not employees of Liberty within the meaning of the FLSA because Liberty did not have the ability to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of payment, and (4) maintained employment records. The court stated that even if Liberty were able indirectly to influence employment decisions made by the contractors, “for the Court to hold that any such influence ... is tantamount to the type of power enjoyed by an employer, would permit an extraordinarily broad definition of employer, even considering the expansive view taken with respect to the FLSA.”

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In reaching its holding, the district court expressly declined to follow the more expansive “economic reality” test that Judge Denise Cote had used to analyze similar factual circumstances in *Lopez v. Silverman.*

**Second Circuit Reverses**

On appeal, the Second Circuit reversed and remanded, stating that the “District Court erred when, based exclusively on the four factors mentioned in *Carter,* it determined that the Liberty Defendants were not, as a matter of law, joint employers under the FLSA.” The court acknowledged that in previous cases it had applied two different tests to determine whether an employment relationship exists for purposes of determining liability under the FLSA. In *Carter,* the court had used the four-factor test described above to assess whether an inmate conducting tutorial classes for a prison was jointly employed by a community college that managed the program. In *Brock v. Superior Care, Inc.,* the court had used a more-expansive five-factor test to determine whether nurses engaged by a health care service were employees rather than independent contractors. The court explained that, despite its consideration of different factors in these and other cases, it had “never suggested that, in analyzing joint employment, the four *Carter* factors alone are relevant, and that other factors that bear on the relationship between workers and potential joint employers should be ignored.” The court noted that in *Rutherford Food Corp. v. McComb,* the Supreme Court held that the definition of “employ” in the FLSA “cannot be reduced to formal control over the physical performance of another’s work.” A corollary, the court found that “the broad language of the FLSA, as interpreted by the Supreme Court in *Rutherford,* demands that a district court look beyond an entity’s formal right to control the physical performance of another’s work before declaring that the entity is not an employer under the FLSA.”

**‘Economic Reality’ Analysis**

On remand, the court directed the district court to conduct an analysis that is based on “the circumstances of the whole activity viewed in light of economic reality.” The court explained that a number of nonexclusive factors were relevant under the circumstances: (1) whether Liberty's premises and equipment were used for the plaintiffs' work; (2) whether the [contractors] had a business that could or did shift as a unit from one putative joint employer to another; (3) the extent to which plaintiffs performed a discrete line-job that was integral to Liberty's process of production; (4) whether responsibility under the contracts could pass from one subcontractor to another without material changes; (5) the degree to which the Liberty defendants or their agents supervised plaintiffs' work; and (6) whether plaintiffs worked exclusively or predominately for the Liberty defendants.

Notably, the court stated that there is no bright-line rule to distinguish between work that “in its essence follows the usual path of an employee” and work that may be outsourced without attracting heightened scrutiny under the FLSA. At one end of the spectrum is work that “requires minimal training, and which constitutes an essential step in the producer’s integrated manufacturing process.” At the other end of the spectrum are cases involving work that “is not part of an integrated production unit, that is not performed on a predictable schedule, and that requires specialized skills or expensive technology.” The court explained that, on remand, the district court should consider industry custom and historical practice to assess this issue. If there is a widespread practice to outsource a particular task, it is unlikely to be a “mere subterfuge to avoid complying with labor laws.” If, however, plaintiffs could establish that a particular contractual device developed in response to applicable labor laws, “the prevalence of that device may, in particular circumstances, be attributable to widespread evasion of labor laws.”

Acknowledging competing policy interests, the court indicated that the “economic reality” test for determining joint employment under the FLSA is intended “to expose outsourcing relationships that lack a substantial economic purpose, but it is manifestly not intended to bring normal, strategically-oriented contracting schemes within the ambit of the FLSA.” The court expressed no view as to whether plaintiffs’ claims would survive a renewed motion for summary judgment under a proper application of the economic reality test. It noted, however, that the district court would be required to make three types of determinations: (1) historical findings of fact that underlie each of the relevant factors, (2) findings as to the existence and degree of each factor, and (3) a conclusion of law to be drawn from applying the factors.

**‘Ling’s’ Holding**

Consistent with the remedial purpose of the FLSA, *Ling broadly construes the statutory definition of “employ” to encompass a wide range of subcontracting relationships. It will be left to future courts to determine what types of “strategically-oriented contracting schemes” fall outside the ambit of the statute.”

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2. A n entity “employs” an individual under the FLSA if it “suffer[s] or permit[t]” that individual to work. 29 USC §203(g). An entity “suffers or permits” an individual to work if, as a matter of “economic reality,” the entity functions as the individual’s employer. See id. at *4 (citing *Goldberg v. Whiskey House Coop., Inc.* 286 US 28, 33 (1961)).
4. 2002 WL 398663, at *6 (citing *Carter,* 735 F2d at 12).
5. Id. at *7.
6. 14 FSupp2d 405, 413 (SDNY 1998). The Lopez court identified seven factors that it found to be relevant in the context of the case, and concluded that the four factors identified in *Carter* could not, on their own, constitute the “economic reality” test, because they rarely permit a finding of joint employment “outside of situations involving direct corporate subsidiaries or managing administrators.” Id. at 415.
8. 840 F2d 1054 (2d Cir. 1988).
11. Id. at *7 (citing *Rutherford,* 331 US at 730).
12. Id. at *6.
13. Id. at *9 (citing *Rutherford,* 331 US at 730 and *Goldberg,* 366 US at 33).
14. Id.
15. Id. at *10.
16. Id.
17. Id.
18. Id.

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