
Noting the FLSA’s expansive language and broad remedial design — and perhaps predisposed to view garment companies as integrated — the court dispensed with a test that evaluated discrete indicia of the formal control exercised by one entity over the employees of another. In its place, the court adopted a broad, nebulous test that invites consideration of a range of facts that, in the court’s view, will better reveal the “economic realities” of outsourcing relationships and expose those that lack a “substantial economic purpose.”

By expanding the inquiry in this way, the Second Circuit no doubt sacrificed predictability in the law. As a result, Liberty Apparel will not only ensure broader enforcement of the FLSA, but it may discourage legitimate outsourcing relationships as well.

Background

Liberty Apparel is a garment manufacturer that hired contractors to perform the last phase of its production process, i.e., sewing fabrics, affixing labels, and otherwise finishing garments in accordance with Liberty’s specifications. Twenty-six employees of such contractors filed a lawsuit in the Southern District of New York, alleging, among other claims, that their employers had failed to pay the minimum wage and overtime pay mandated by the FLSA and its New York analog. The plaintiffs claimed that, in addition to the contractors, Liberty was their employer as well, and thus it too was liable for the statutory violations.

The district court rejected this argument and granted summary judgment in favor of Liberty. In concluding that Liberty was not a joint employer of the plaintiffs, the district court applied a four-factor “economic realities” test set forth by the Second Circuit in Carter v. Dutchess Community College, 735 F.2d 8 (2d Cir. 1984).

Specifically, the district court held that Liberty did not sufficiently control the plaintiffs to constitute their employer, in that it “did not (1) hire and fire the plaintiffs, (2) supervise and control their work schedules or conditions of employment, (3) determine the rate and method of payment, or (4) maintain employment records.”

In a departure from Carter, the Second Circuit reversed on appeal. The court found that the four-factor test is “unduly narrow” and cannot be reconciled with the expansive language of the FLSA, as interpreted by the U.S. Supreme Court in Rutherford Food Corp. v. McComb, 331 U.S. 722 (1947).

Though the Second Circuit explained its decision as being consistent with precedent, Liberty Apparel is undeniably new law.

Second Circuit Precedent

In Carter, the Second Circuit embraced the formalistic, four-part test that it would later eschew in Liberty Apparel. Carter involved the question whether, under the FLSA, a college jointly employed inmates who taught classes in a program managed by the
college. The lower court granted the college’s motion for summary judgment, finding that the college lacked “ultimate control” over the inmates.

Applying the four-factor test, the Second Circuit reversed. The court explained that, “in determining whether an employment relationship exists for purposes of the FLSA, [courts] must evaluate the ‘economic reality’ of the relationship.” Without ever citing Rutherford — the touchstone for the Liberty Apparel analysis — the court further explained as follows:

In applying the economic reality test, the material facts are whether the alleged employer could hire and fire the worker, control work schedules and conditions of employment, determine the rate and method of payment, and maintain employment records.

Based on its evaluation of these four “material facts” — and no others — the court reversed the lower court’s grant of summary judgment.

Fifteen years later, in Herman v. RSR Security Services, 172 F.3d 132 (2d Cir. 1999), the Second Circuit again applied the four-factor test. There, it affirmed the lower court’s consideration of material facts — and no others — the court reversed the lower court’s grant of summary judgment.

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In the court’s view, in order to draw this distinction and give meaning to the FLSA’s “expansive language” — which requires coverage over any entity that “suffers or permits” an individual to work — it is necessary to look “beyond a defendant’s formal control over the physical performance of a plaintiffs’ work.” Thus, while the indicia of formal control embodied by the Carter test remain relevant, they are no longer essential to the joint employer analysis.

Also relevant, the court found, are certain, less stringent factors that are traditionally used to distinguish employees (who are covered by the FLSA) from independent contractors (who are not). In explaining that the economic realities analysis is not limited to the Carter factors, the Second Circuit relied heavily on Lopez v. Silverman, 14 F. Supp.2d 405 (S.D.N.Y. 1998). In that case, the district court evaluated joint employer status by applying the Carter factors, which “rarely permit a finding of joint employment,” as well as factors from the independent contractor test, which are “equally skewed in the opposite direction.”

Drawing from Lopez, and even more heavily from Rutherford, the Second Circuit identified the following six factors, which are designed to detect “functional control over workers even in the absence of the formal control measured by the Carter factors:"

1. Whether the putative joint employer’s premises and equipment were used for the employees’ work.
2. Whether the contractor’s business could or did shift as a unit from one putative joint employer to another. According to the court, a contractor that primarily serves a single client is more likely to be part of a subterfuge arrangement.
3. The extent to which the employees are part of a production line, i.e., performing a discrete job that is integral to the putative joint employer’s production process. The court explained that piecework that involves minimal training or equipment and is part of an integrated process may evince a subterfuge, whereas work involving specialized skill or technology and no predictable schedule does not. The court also noted that an arrangement is

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**Liberty Apparel.**

**The New Analysis**

In Liberty Apparel, the Second Circuit outright rejected the Carter test, concluding that the district court “erred when it limited its analysis to the four factors identified in Carter.” Yet, in an effort to reconcile its decision with settled precedent, the court explained that, in Carter and Herman, it had held “only that the four factors ... can be sufficient to establish employer status,” not that they are necessary to do so.

After confining Carter and Herman to their facts, the Second Circuit

**Given the FLSA’s remedial scheme, the chilling effect of ‘Liberty Apparel’ could be substantial. FLSA claims may give rise to liquidated damages, as well as recovery for a three-year period if violations are found to be willful — a strong possibility if the ‘Liberty Apparel’ test is met, given its design to detect “subterfuge” arrangements.**

In explaining that the economic reality of the relationship is not limited to the four factors, the Second Circuit also noted that an arrangement is more likely to be part of a subterfuge arrangement.

3. The extent to which the employees are part of a production line, i.e., performing a discrete job that is integral to the putative joint employer’s production process. The court explained that piecework that involves minimal training or equipment and is part of an integrated process may evince a subterfuge, whereas work involving specialized skill or technology and no predictable schedule does not. The court also noted that an arrangement is
less likely a subterfuge if the work at issue is customarily outsourced — unless, of course, the custom developed as a way to avoid labor laws.

4. Whether responsibility under the contracts would pass from one contractor to another without material change. This factor favors a joint employer finding when the workers are “tied” to the putative joint employer more so than to their “ostensible direct employer.”

5. The degree to which the putative joint employer supervised the employees’ work. The court distinguished supervision regarding the workers’ terms and conditions of employment, which supports a joint employer finding, from supervision regarding the quality or timely completion of the work, which does not.

6. Whether the employees worked “exclusively or predominantly” for the putative joint employer. In the court’s view, such dependence suggests that the putative joint employer has assumed “functional control” over the contractor’s employees.

These six factors are not the only relevant considerations. Rather, a court is “free to consider any other factors it deems relevant to its assessment of the economic realities.” Further, no single factor is determinative, and joint employer status may be found even if every factor does not support such a finding.

While such agreements generally run afield of the National Labor Relations Act’s (NLRA) prohibition against “secondary boycotts,” they are permissible in the garment industry. Thus, under the NLRA’s “garment industry proviso,” entities that perform “parts of an integrated process of production” are considered one in the same, such that a union may pressure one to advance its interests with respect to another. The new joint employer analysis — which likewise rejects mere formalistic distinctions between a manufacturer and a contractor — seems rooted in the same view of the industry.

Regardless of the court’s rationale, one thing is clear: Though the court was careful to acknowledge “the substantial and valuable place that outsourcing [has] come to occupy in the U.S. economy,” Liberty Apparel no doubt portends stricter scrutiny of such arrangements.

Notwithstanding its efforts to reconcile the new analysis with precedent, the court plainly intended a more expansive approach to FLSA enforcement. For example, it repeatedly stated that the Carter test unduly limited the “expansive” language of the FLSA, thus compromising the statute’s broad remedial purpose. Further, the court drew heavily from Lopez, in which the district court supplemented the Carter test with factors that admittedly were “skewed” toward a joint employer finding. Rhetoric aside, therefore, the Second Circuit plainly has cast a net designed to snare far more outsourcing arrangements than the Carter test ever did.

Further, in guaranteeing heightened FLSA enforcement in this arena, the court has imperiled legitimate outsourcing relationships as well. Gone is the test that used four discrete factors to gauge the formal control exercised by a putative joint employer. In its place, the Second Circuit has inserted a free-flowing, multi-factor test whose application is far less predictable. Indeed, the court even acknowledged that three of the new factors — shared premises, absence of a broad client base, and part of a production line — may be “perfectly consistent with a legitimate subcontracting relationship.”

Moreover, in stark contrast to the Carter test, other factors — most notably, whether the contractor’s business could shift to another joint employer and whether the workers are part of a production line — are so nebulous as to preclude uniform application.

As a result, lacking sufficient guidance in the law, prudent companies may shy away from outsourcing relationships that are, in fact, legitimate.

Indeed, given the FLSA’s remedial scheme, Liberty Apparel’s chilling effect could be substantial. FLSA claims may give rise to liquidated damages, as well as recovery for a three-year period if violations are found to be willful — a strong possibility if the Liberty Apparel test is met, given its design to detect “subterfuge” arrangements. Particularly with such remedies looming, in the absence of predictability in the law, companies may think twice before undertaking arrangements that, in the court’s own words, hold a “substantial and valuable place” in the economy.

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