When Outsourcing Cheats Workers
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More than 60 years after the passage of federal minimum wage and overtime laws, hundreds of West African immigrants were working twelve hours a day, seven days per week, for as little as $1.25 per hour, at New York City's largest retail grocery stores and pharmacies. How could well-known, multi-billion dollar companies, such as Duane Reade, A&P, and Gristede's, so openly and egregiously violate the law? Welcome to "outsourcing"— a corporate practice touted by business visionaries as a way of focusing on core competencies and producing efficiencies, but also a tried and true means of lowering labor costs, escaping liability for employment law violations, and blocking labor organizing efforts, all achieved by avoiding a formal employment relationship with outsourced workers.

The retailers claimed that they did not employ the delivery workers. Instead, they contracted with independent delivery companies who hired and paid the workers. The retailers, however, supervised and controlled the workers on a daily basis. Extending the outsourcing arrangement to an absurd extreme, the delivery companies asserted that they, too, did not "employ" the delivery workers. Instead, each worker was an "independent contractor," or private businessman, who sold his own services to the delivery company. Thus, each immigrant deliveryman was ostensibly his or her own employer.

Wage Violations in Subcontracting Arrangements

In low-wage industries such as retail and manufacturing, rampant wage-and-hour violations often hide behind subcontracting arrangements. Rather than directly employ janitors or line production staff, companies commonly outsource those services to contractors who compete with one another for the opportunity to provide the same services. To win and retain the contract, contractors must offer the lowest price. To do so, they push wages as low as possible, often below the legal minimum. The contractors can get away with this because there is a near limitless supply of unskilled workers, often undocumented immigrants, desperate for work and with few options to support their families.

Contractors are willing to gamble with liability for wage-and-hour violations as a business practice because the risk of getting caught is small and the penalties insufficient to outweigh the benefits. State and federal governments consistently refuse to allocate to their labor departments the resources to effectively police hundreds of thousands of small businesses. Exploited workers rarely report violations, either out of ignorance, concern for losing their jobs, or fear of other forms of retaliation — including a call to immigration authorities. Contractors know that, even if hit with a judgment for unpaid wages they can, as small, undercapitalized businesses, simply close their doors and open up shop under a new name down the street. Any real minimum wage enforcement effort, therefore, must target not only the contractor, but also the outsourcing company that benefits from the wage-and-hour violations through lower production costs. Under a legal concept known as "joint employment," advocates and government attorneys can prosecute the bigger, more established company, along with its contractors, for the illegal wages paid to outsourced workers. Joint employment recognizes that two or more individuals or companies can be the legal employers of a single employee. By holding the ultimate beneficiary of the workers' labor responsible for ensuring proper wages, joint employment encourages companies to police their own contractors for wage violations, rather than turn a blind eye.

Ansoumana v. Gristede's

In the case of the West African delivery workers, Outten & Golden LLP, along with the National Employment Law Project (NELP) and the New York Attorney General, prosecuted the retailers as well as their delivery contractors for willful violations of the federal Fair Labor Standards Act (FLSA) and the New York Labor Law. Ansoumana v. Gristede's Operating Corp.,1 filed as a collective and class action suit on behalf of hundreds of immigrant delivery workers,2 challenged the practice of concealing responsibility for minimum wage and overtime through outsourcing. Three different subcontractors hired O&G's clients, as independent contractors, rather than employees, to escape the requirements of paying minimum wage and overtime (and employment taxes, including FICA and unemployment insurance). The contractors were essentially shell corporations consisting of one or two principals, themselves friends and/or relatives of the principals, each working in tandem. The retailers paid the contractors a flat fee ranging from $115 to $300 per week for each delivery worker; the contractors in turn paid the workers $75 to $90 per week, or as little as $1.25 per hour, for 60 to 84 hours of work. Because no one could deny that the plaintiffs had not received the minimum wage and overtime pay, the case centered on the question of who legally employed the workers, and therefore was liable for the unpaid wages. Ultimately, O&G recovered more than $7,220,000 from Gristede's, Duane Reade, A&P, and the labor contractors for violations of minimum wage and overtime laws for approximately 1000 workers.

The Legal Basis of Joint Employment

As a legal matter, joint employment turns on the definition of "employer" and "employ."3 The FLSA and New York Labor Law both define "employ" as "to suffer or permit to work." This is the broadest definition of employment of any federal statute. Courts have commented for years on the "striking breadth" of employment relationships under the FLSA, which is attributed to its remedial purpose of eliminating a wide range of "labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers." 29 U.S.C. § 202(a). The FLSA definition extends beyond the ancient common-law concept of employment, which is based on control of "servants," to capture relationships that, though lacking in formal control, exhibit a level of dependence such that, "as a matter of economic reality," one suffers or permits another to work.4

Courts have found joint employment situations for workers in such disparate circumstances as home health care workers,5 farm workers,6 garment workers,7 and subcontracted cleaning services.8 Currently, Wal-Mart faces a class action suit in New Jersey on behalf of more than ten thousand janitors, most of whom are undocumented immigrants, who worked in Wal-Mart stores nationwide but were formally employed by more than 100 subcontractors. The janitors, who claim that Wal-Mart is a joint employer, worked eight hours per night, seven nights a week, without ever receiving overtime payments. In a related case, Wal-Mart recently paid $11 million to the federal government to settle allegations of immigration law violations caused by the same cleaning contractors hiring hundreds of undocumented workers.

A joint employment relationship exists where the employee performs work that simultaneously benefits two or more employers and:

(1) Where one employer is acting directly or indirectly in the interest of the other employer (or employers) in relation to the employee; or

(2) Where the employers are not completely disassociated with respect to the employment of a particular employee and may be deemed to share control of the employee, directly or indirectly by reason of the fact that one employer controls, is controlled by, or is under the common control with the other employer. 29 C.F.R. § 791.2.

It is not always self-evident whether one is "acting directly or indirectly in the interest of the other employer" or whether two employers are "not completely disassociated with respect to the employment" of an employee. Therefore, courts have established different tests for determining whether in "economic reality" a putative joint employer bears a close enough relationship to the employee to impugn employer status and joint liability for wage violations.

For many years, the federal appeals court in New York, the Second Circuit, had stated that the economic reality test was a "totality of the circumstances analysis," but focused primarily on four factors that concern the power of control. See Carter v. Dutchess Community College, 735 F.2d 8. One lower federal court in New York applied a more expansive seven-factor test for joint employment that combined the four Carter factors with several factors taken from a later Second Circuit case that analyzed whether nurses were employees or independent contractors of a putative employer. See Lopez v. Silverman, 14 F. Supp. 2d 405 (S.D.N.Y. 1998).

Then, in December 2003, the Second Circuit revisited the question of what constitutes "economic reality" for purposes of joint employment liability under the FLSA, in a case called Zheng v. Liberty Apparel, Inc., 355 F.3d 61. In Zheng, the lower court had applied the same four factors from Carter — whether the putative 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, 4) maintained employment records — and determined on summary judgment that no joint employment existed. On appeal, the Second Circuit clarified that the four Carter factors, while sufficient to find joint employment, are not necessary because they focus solely on the formal right to control, which is the hallmark of common law employment. Id. at 69. Instead, reaching back to the Supreme Court's 1946 decision in Rutherford Food Corp. v. McComb, 331 U.S. 722 (1946), the Second Circuit identified six factors that were relevant to determining the economic reality of an subcontracted employee's relationship to a putative joint employer.

In Rutherford, the Supreme Court held that the slaughterhouse employed the workers who deboned meat notwithstanding the presence of a subcontracting relationship with an independent boning supervisor who hired, paid, and supervised the workers. The six Rutherford factors identified by the Zheng court are: (1) whether the putative joint employer's premises and equipment were used for the plaintiff's 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 the putative joint employer's process of production; (4) whether responsibility under the contracts could pass from one subcontractor to another without changes; (5) the degree to which the putative joint employer or its agents supervised plaintiffs' work; and (6) whether plaintiffs worked exclusively or pre-dominantly for the putative joint employer.

Zheng is important because it rejected the limited, control-based analysis of Carter as an exclusive measure of joint employment. The court reaffirmed the expansiveness of employment under the FLSA and reinforced the distinction between common law employment and the economic reality test. Zheng, however, did not go far enough in its explanation of the economic reality test. First, it simply pulled out the factors cited in Rutherford, which were somewhat distinct to that factual situation and were not supposed to be exhaustive. It did not offer a comprehensive vision of what is "economic reality."

Second, the decision suffers from the court's preoccupation with protecting "legitimate outsourcing" arrangements from being enveloped by joint employment. The court was "mindful of the substantial and valuable place that outsourcing, along with the subcontracting relationships that follow from outsourcing, have come to occupy in the American economy." Id. at 73 (citing "The Outing of Outsourcing," The Economist, Nov. 25, 1995, at 57, 57). That concern led the court to attempt to distinguish proper outsourcing from subcontracting that is a mere "subterfuge" for evading wage and hour laws, and to limit joint employment as much as possible to the latter situation.

Zheng's neat distinction between legitimate and illegitimate subcontracting breaks down in reality, especially in low-wage industries. Subcontracting may offer both real efficiencies achieved through specialization as well as a scheme for paying illegal wages, making distinguishing the "true motivation" behind subcontracting difficult. In Chen v. Street Beat Sportswear, Inc., 2005 WL 774323 (E.D.N.Y. 2005), the first post-Zheng joint employment case in New York, experts offered competing explanations for the rise of subcontracting in the garment industry decades ago. Defendants' expert explained that by outsourcing its sewing, defendants could produce its garments more cheaply and efficiently, thereby allowing defendants to "remain competitive in the increasingly global garment industry." Id. at 10. Plaintiffs' experts testified that outsourcing in the garment industry developed historically as a means of lowering labor costs and standards. They argued that defendants achieved cheaper production, not as a result of efficiencies created by contractors' expertise or size, but rather through sub-minimum wages achieved because "the manufacturer will not be subject to liability in damages for wage and hour violations to which the workers hired by the contractor to assemble the manufacturers' garments are subjected." They noted that illegal wages are "endemic to the garment industry because contractors that hire workers such as plaintiffs do not earn enough under the contracts with manufacturers to adequately pay them." Id. at 9.

In the same attempt to safeguard legitimate outsourcing, Zheng inappropriately equated "economic reality" with "economic purpose," thereby over-limiting joint employment to only those outsourcing arrangements that have no valid economic basis in terms of efficiency or other value. Rutherford makes clear that the economic reality test seeks to identify whether the worker's efforts are sufficiently allied with the company's business such that, regardless of common law employment, the company in effect suffers or permits him or her to work. Thus, properly applied, the FLSA may extend to legitimate subcontracting relationships, if they provide services that are integral to the joint employer's business.

The fallacy of requiring subterfuge as a precondition for joint employment is seen in the example of individual employer liability. It is common under the FLSA to find that individual owners of a company who have operational control over the employer company themselves meet the definition of employer and are therefore joint employers along with the company. See Herman v. RSR Security Services, Ltd., 172 F.3d 132, 139 (2d Cir. 1999). Such a determination of liability is not premised on some finding that the individual is using the corporation as an illegitimate shield from liability, but rather that the individual meets the very broad definition of employer under the statute. Similarly, joint employment by two separate companies should be guided by the breadth of the statute's definition, which includes the economic dependence of the worker on a putative employer.

Zheng's emphasis on subterfuge jeopardizes full enforcement of the FLSA's remedial purpose, particularly in areas like the garment industry where contractors routinely flout the dictates of the FLSA as a business practice, for the sake of avoiding any risk to so-called legitimate outsourcing. While more expansive liability may present a minor disincentive to subcontracting, it's unlikely to fully deter subcontracting that is fueled by real economic efficiency, whereas more liberal joint employment standards will certainly dampen subcontracting that is motivated solely by a desire to avoid liability. Therefore, courts should err on the side of holding companies jointly liable for subcontractors' violations, even where real efficiencies exist to justify the outsourcing, to carry out the FLSA's remedial purposes and to encourage companies to monitor their subcontractors' compliance with wage laws.

Zheng's concern for "legitimate" outsourcing relationships unduly narrows the Rutherford factors. While, on the one-hand, announcing that the degree to which the putative employer supervises the plaintiff's work is a relevant factor in joint employment determinations, the court then limited the factor to only supervision that demonstrates effective control of the terms and conditions of employment, citing a business journal that stated that "the most successful outsourcers find it absolutely essential to have both close personal contact and rapport at the floor level and political clout and understanding with the supplier's top management." 355 F.3d at 75 (quoting James Brian Quinn and Frederick G. Hilmer, "Strategic Outsourcing," Sloan Mgmt. Rev., Summer 1994, at 43, 53).

Rutherford suggests that greater direct supervision by the company of its contractor's employees indicates that the work performed is more closely aligned with the company and being performed for the company's benefit. While not every instance of supervision should be sufficient to find joint employment, the court unnecessarily tightens the standard in order to try to protect "legitimate" outsourcing.

Joint Employment in *Ansoumana*

In Ansoumana, the court easily found that the retailers, along with their labor contractors, were joint employers of the delivery workers.9 Though decided before Zheng, the court's determination is equally supported under the new six-factor test. Not only did the plaintiffs work from the retailers' premises and perform a task that was integral to the companies' business, they also regularly assisted the retailers' employees with non-delivery work such as bagging, stocking, and security. Store managers directed these employees in their work, and the plaintiffs worked exclusively for the retailer to whom they were assigned. Finally, the court found that the relationship between the retailer and the labor intermediary was "so extensive and regular as to approach exclusive agency." 255 F. Supp. 2d at 195.
In contrast to Zheng's conflation of joint employment and wrongdoing, Judge Hellerstein properly distinguished between the issue of joint employment and the ends pursued by joint employers through subcontracting. "Duane Reade had the right to 'outsource' its requirement for delivery services to an independent contractor…and seek, by outsourcing, an extra measure of efficiency and economy in providing an important and competitive service. But it did not have the right to use the practice as a way to evade its obligations under the FLSA and the NY Minimum Wage Act." 255 F. Supp. 2d at 196. Holding retailers accountable for their contractors' wage violations allows retailers to benefit from efficiencies created by outsourcing but rightly requires them to police their contractors to ensure that cost savings aren't achieved through systematic violation of wage and hour laws.

Another Solution

Wage violations attendant to outsourcing are so rampant in the garment industry that the United States Department of Labor has become increasingly aggressive in policing the industry. In certain cases it has required manufacturers to sign compliance agreements pursuant to a so-called "hot goods" provision of the law, which makes it illegal "to transport, … ship … or sell … any goods" whose production involved violations of the minimum wage, overtime, or child labor provisions of the FLSA. 29 U.S.C. § 215(a). Under such agreements, as seen in Street Beat, manufacturers agree to monitor their contractors' compliance with the FLSA through such efforts as performing feasibility analyses to determine whether their contract prices could reasonably support payment of legal wages, requiring contractors to sign employer compliance programs (ECP) that commit them to abide by the FLSA, making retroactive adjustments when prices were insufficient to cover costs and pay legal wages and reporting any known wage violations to the DOL. The manufacturer is required to report its compliance efforts on a semi-annual basis, and failure to comply with the agreement can result in the manufacturer being required to pay back wages for the employees of contractors who have failed to pay minimum wage and overtime to their workers. Chen v. Street Beat Sportswear, Inc., 2005 WL 774323, *22 n.48. Compliance agreements offer obvious advantages over reliance on joint employment. The proactive monitoring requirements aim to identify and prevent/redress wage violations by contractors and, by holding manufacturers accountable, reorient the financial incentives to promote compliance. All this is accomplished irrespective of the intensive and somewhat uncertain joint employment analysis. Moreover, the agreement constitutes an enforceable contract to which the contractors' employees are third party beneficiaries with the independent ability to enforce.

While compliance agreements are well-suited to the garment industry because of the special "hot goods" provision, contractual enforcement through employers may be more difficult in the service industry, which generally produces no tangible "hot good" at all. Furthermore, with its resources scarce, the government simply cannot police every instance where outsourcing is being used as a tool to evade minimum labor standards. The DOL typically enters into a compliance agreement with a manufacturer only after repeated complaints about its contractors; so such a solution is imperfect at best.

Conclusion

Outsourcing is not all bad. Often companies rely on subcontractors for specialized services on an as-needed basis. In low-wage industries, however, companies commonly use outsourcing to evade responsibility for paying the minimum wage. While not all outsourcing should carry with it joint employer responsibility, when employers have significant economic control over their contractors' workers, they are in a position to monitor and to affect their contractors' employment practices. Under such circumstances, the FLSA should hold companies jointly liable with their contractors.

In Zheng, the Second Circuit recognized the tension between outsourcing as a positive economic force and as a means to duck the law, but struck the wrong balance. In attempting to safeguard legitimate outsourcing, the court defined joint employment too narrowly. The FLSA's expansive coverage of employment relationships is not intent-driven; economic reality goes to the dynamics of economic power relationships, not the party's intent to evade the law. The overriding policy concern must be to ensure that proper wages are paid.

Ansoumana properly recognized that it is incumbent on employers — including those who farm out their own work — to make sure wages are paid. In the interests of deterring violations and ensuring that workers are paid (or if not, can actually recover) minimum and overtime wages, courts should err on the side of broader joint employer coverage. Whether we use joint employment, compliance agreements, or some other means, the company that ultimately benefits from the subcontracted workers' labor and controls the terms of the subcontracting relationships must face a real economic price if we hope to end the sorts of egregious wage violations found in Ansoumana and every day in sweatshops throughout the country.

Editor's Note:

Unrecognized workers, whether outsourced or not, face exploitation in the form of poverty wages, forced "off the clock" overtime, lack of medical coverage or other benefits, and more. Cases such as Ansoumana can provide a powerful tool allowing some workers to address flagrantly illegal acts, bringing some egregious violations to the public's attention.

As noted in this article, however, workers cannot count upon the availability of government compliance mechanisms to ensure the law is enforced. Moreover, even the Fair Labor Standards Act does not enforce an obligation beyond the payment of federal minimum wage, which is not enough to live on. It is for this reason that Coalition of Concerned Legal Professionals, throughout its history, has worked alongside organizations of seasonal and service workers, domestic workers, farm workers, temporary and other low-paid workers in building organization to address those divisions of labor — both legally and practically — that pit one group of workers against another and allow them to be exploited by the unscrupulous or the uncaring. In this context, it is not efficient for society as a whole when businesses externalize costs by dumping them on others or making impoverished workers do without. For our economy to function efficiently, living wages must be paid to all workers at all times. The plight of poor workers is a problem demanding ever-vigilant action by everyone in a position to help. We call upon legal professionals and others concerned about the plight of low-income working people to join with us in this struggle.

1 255 F. Supp. 2d 184 (S.D.N.Y. 2003)(J. Hellerstein).

2 The federal Fair Labor Standards Act, 29 U.S.C. 201 et seq., provides for opt-in "collective actions." In contrast, claims under the New York Labor Law, which has the benefit of a six-year statute of limitations compared to the two-year (or three-year in the case of willful violations) statute of limitations under the FLSA, can be brought as an opt-out class action under Rule 23 of the Federal Rules of Civil Procedure. Ansoumana was one of the first "hybrid" class actions, combining an FLSA collective action and a Rule 23 class action asserting state claims. Ansoumana, 201 F.R.D. 81 (S.D.N.Y. 2001).

3 "Employer" is defined broadly, but somewhat circularly, as "any person acting directly or indirectly in the interest of an employer." 29 U.S.C. § 203(d).

4 Bartels v. Birmingham, 332 U.S. 126, 130 (1947).

5 Bonnette v. California Health & Welfare Agency, 704 F.3d 1465 (9th Cir. 1983)(holding that counties and individual recipients were joint employers of "chore" workers who provided in-home services for disabled public benefit recipients).

6 Martinez-Mendoza v. Champion Intern. Corp., 340 F.3d 1200 (11th Cir. 2003)(holding that farm labor contractor and agricultural employer were joint employers).

7 Lopez v. Silverman, 14 F. Supp. 2d 415 (S.D.N.Y. 1998)(holding that contractor and jobber were joint employers of garment workers under a seven-prong test).

8 Vega v. Contract Cleaning Maintenance, Inc., 2004 WL 2358274 (N.D.Ill. 2004)(ruling, on a motion to dismiss, that UPS may be a joint employer with its cleaning subcontractor of cleaning service employees).

9 Before finding joint employment, Judge Hellerstein first held that plaintiffs were in fact employees of the labor intermediaries rather than independent contractors. Though this finding also turned on the broad definition of 'employ', the analysis of whether someone is an independent contractor or an employee is different than whether someone is an employee of a single company or jointly employed by a subcontractor and contractor, 255 F. Supp. 2d 184, 190-192 (applying five-factor economic reality test in Brock v. Superior Care, Inc., 840 F.2d 1054 (2d Cir. 1988)). Judge Hellerstein easily found that these unskilled, immigrant workers, many of whom did not speak English, who were subject to control by the intermediaries and performed an integral part of the companies' business, were in fact employees and not independent businessmen. Id. at 190-92. Judge Hellerstein also found that the individual owners of the labor intermediaries qualified as employers and were therefore jointly and severally liable, because they were owners who exercised operational control over the company. Id. at 192-93.