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THE REGULATORY HOUR: THE HISTORY, LAW AND ECONOMICS OF MINIMUM WAGE AND MAXIMUM HOURS LEGISLATION

Richard A. Epstein *

ABSTRACT: For over one-hundred years the legal regulation of minimum wage and maximum hour laws has struggled to find an appropriate answer to two questions. First, what counts as a regulated hour, and second, who counts as a covered employee? The

* The Laurence A. Tisch Professor of Law, The New York University School of Law, the Peter and Kirsten Senior Fellow, the Hoover Institution, the James Parker Hall Distinguished Service Professor of Law, and Director, the Classical Liberal Institute at NYU Law School. This paper has been prepared as part of a project of innovation in modern society that has been provided to the Classical Liberal Institute by the Templeton Foundation. Professors Seth Oranburg and Liya Palagashvili are coinvestigators on the project. My thanks to Max Semels, The University of Chicago Law School, class of 2019 and Denis Rondeau, class of 2020, for their valuable research assistance.

traditional economic analysis of these laws assumes that all hours are homogeneous, i.e. impose the same cost to workers and provide the same benefit to employers. Historically, a variation in the work intensity of different hours has led to immense complications in the administration of the law, including key cases like *Lochner v. New York* (1905) and *Skidmore v. Swift & Co.* (1944), both of which trip up in deciding how to include hours sleeping on the job into the relevant calculations. These issues have carried forward into modern law dealing with other types of variable pay schedules distinct from what is seen in industrial plants, with the rules being applied to such groups as interns, research assistants, start-up employees, and workers in the gig economy, all of which have been subject to extensive litigation.

This historical evolution involves the interaction between substantive rules and administrative regulation. It also shows the shaky underpinnings of the minimum wage and overtime regulations, where the adverse consequences often spill over into the legislative arena, and constitutes a strong, if overlooked argument for their repeal. But even though these federal and state statutes are now treated, courts and administrators should construe them in ways that make categorical distinctions between covered and uncovered workers, for a system of ad hoc individual determinations creates untenable levels of uncertainty in a mass economy, uncertainty that can only be alleviated by clear per se rules that keep these marginal categories out of the class of employees.

INTRODUCTION

The Ubiquity of the Hour The rise of the innovation economy in recent years has forced courts to address novel legal challenges by attempting to adapt traditional legal norms to new technological innovations. These challenges commonly arise in three arenas: the gig economy, industry start-ups and university research programs. The problems in each of these sectors often differ. But, surprisingly enough, one issue continually comes to the surface, albeit in different guises: What is the definition of an hour for minimum wage and overtime laws for covered employees? Yet, in some deep sense, the novelty of this issue cannot be overstated. The question of defining

the regulatory hour is not just a question of counting out sixty minutes. The question of deciding who is an employee is not just a question of reading a contract. The larger questions are whether the hour is a good proxy for thinking about compensation for individual workers, and whether the employment relationship is a good location for applying these standards. The many hidden challenges on these twin issues are not confined to modern innovation industries. Instead, the question of wages and hours legislation goes back to the beginning of the progressive era, when the rising pace of industrialization created pressures to introduce the maximum hours legislation that lay at the heart of *Lochner v. New York*.[1] And when *Lochner* was overturned it was only a short time before the hour become a source of controversy under the Fair Labor Standards Act of 1938 (FLSA),[2] which followed three years after the enactment of

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[1] *Lochner v. New York*, 198 U.S. 45 (1905).

[2] Fair Labor Standards Act of 1938, 29 U.S.C. § 201, et seq.

> § 202. Congressional finding and declaration of policy
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> (a) The Congress finds that the existence, in industries engaged in commerce or in the production of goods for commerce, of labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers
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> (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States;
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> (2) burdens commerce and the free flow of goods in commerce;
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> (3) constitutes an unfair method of competition in commerce;
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> (4) leads to labor disputes burdening and obstructing commerce and the free flow of goods in commerce; and
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> (5) interferes with the orderly and fair marketing of goods in commerce. That Congress further finds that the employment of persons in domestic service in households affects commerce.

the National Labor Relations Act of 1935.[3] The issues under the FLSA have raised profound and enduring questions of constitutional and administrative law. But to my knowledge there has been no systematic study of wages and hour regulations as a discrete topic. There are no law school courses devoted to the subject, and I have not encountered any article that attacks this critical issue head on. Instead, in both the courts and the academic literature, these issues have been addressed in the context of constitutional and administrative law, where the definitions of an hour or an employee are merely supporting cast members. In constitutional law, the central question is whether the regulation of economic liberties should receive a high or low level of scrutiny. The parallel inquiry under administrative law is the extent to which deference should be accorded to the interpretation of administrative agencies in connection with the oft-defended and much criticized Supreme Court decision in *Chevron, Inc. v. NRDC*,[4] and its kid sister, the FLSA case *Skidmore v. Swift & Co.*[5]

The approach that I take in this article is quite different. I concentrate first on the structure of the various statutory provisions and how that structure influences the behavior of firms and influences the overall structure of labor markets. The constant inquiry is whether these statutory provisions require a deviation from some prior firm practice, and whether those mandated deviations improve or harm the overall level of firm output or social

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> (b) It is declared to be the policy of this chapter, through the exercise by Congress of its power to regulate commerce among the several States and with foreign nations, to correct and as rapidly as practicable to eliminate the conditions above referred to in such industries without substantially curtailing employment or earning power.

The odd feature about these claims is that it assumes that interstate trade, which normally enhances welfare, somehow detracts from it.

[3] National Labor Relations Act, 29 U.S.C. § 151-169 (1935).

[4] *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984).

[5] *Skidmore v. Swift & Co.*, 323 U.S. 134, 65 S. Ct. 161 (1944).

welfare. Yet in all the cases that I have reviewed, this question of industrial structure and legal incentives plays at most a highly subordinate role. These legal blinders lead even those judges who are aware of the difficulties with the FLSA, to avoid asking whether that law, or any state law analogue, imposes serious hardship on the regulated firms and their workers, without offering any compensating social advantages. There are two responses to this larger challenge. First, can the adverse impacts of any given decision be reduced by an alternative interpretation of the statute? Second, are the structural defects so ingrained that it is better to abandon the entire regulatory effort than to deal with wages and overtime under the FLSA and analogous statutes? The answer to both questions is yes.

These conclusions will raise eyebrows because of the modern legal orthodoxy's deeply engrained assumption that these laws are needed to "protect" workers from overreaching by employers. The point is made clear in the many Supreme Court cases that deal with the FLSA in the formative period that covered the ten years after its initial passage in 1938. One typical statement of that principle was that Congress enacted the FLSA "to aid the unprotected, unorganized and lowest paid of the nation's working population; that is, those employees who lacked sufficient bargaining power to secure for themselves a minimum subsistence wage."[6] The scope of the statute is, however, larger than this target class. It applies whether or not workers are unionized, and its application is not limited to the weakest and least educated members of the American workforce.

Nonetheless, this rationale carried the day in the critical 1941 case of *United States v. Darby,*[7] which upheld the constitutionality of the FLSA. The exact challenge in the case was not framed as a defense of economic liberties. Rather, in *Darby*, a federal district court had upheld the defendant's challenge that Congress lacked the power to

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[6] *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697, 707 n18 (1945).
[7] *United States v. Darby*, 312 U.S. 100, 61 S. Ct. 451 (1941).

regulate manufacturing within the states, rejecting the United States' argument that Congress had an absolute power to prevent the shipment of these goods into interstate commerce. That position had explicitly been rejected by the United States Supreme Court in *Hammer v. Dagenhart*,[8] which struck down a federal statute that forbade any firm in North Carolina to ship its goods into interstate commerce if it used in any of its operations child labor under the age of 14. The relevant federal statute called for a 16-year minimum.

In *Darby* Justice Stone, writing for a unanimous court, not only overruled *Hammer* but went one step further and held that the direct regulation of these plants was permissible whether or not the goods were shipped into interstate commerce.[9] The question of constitutional power was not decided, however, in some intellectual void. Rather, the Court unanimously held that substandard labor conditions were themselves a peril to interstate commerce.[10] He wrote:

> As we have said the evils aimed at by the Act are the spread of substandard labor conditions through the use of the facilities of interstate commerce for competition by the goods so produced with those produced under the prescribed or

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[8] *Hammer v. Dagenhart*, 247 U.S. 251, 38 S. Ct. 529 (1918). The effort to substitute a tax for the regulation was rebuffed by the Court in *The Child Labor Tax Case*. For my defense of that decision, see Richard A. Epstein, *The Classical Liberal Constitution* 114 (Harvard 2014).

[9] *Darby*, 312 U.S. at 115-116.

[10] 29 U.S.C. § 202(a) The Congress hereby finds that the existence, in industries engaged in commerce or in the production of goods for commerce, of labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and obstructing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce.

> better labor conditions; and the consequent dislocation of the commerce itself caused by the impairment or destruction of local businesses by competition made effective through interstate commerce. The Act is thus directed at the suppression of a method or kind of competition in interstate commerce which it has in effect condemned as "unfair," as the Clayton Act has condemned other "unfair methods of competition" made effective through interstate commerce.
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> The Sherman Act and the National Labor Relations Act are familiar examples of the exertion of the commerce power to prohibit or control activities wholly intrastate because of their effect on interstate commerce.[11]

The difficulties with Justice Stone's oft-rehearsed passage are manifold. It first contains no definition of substandard conditions or documentation that those conditions exist, or, if they exist, how they relate to the allegedly sad state of interstate commerce. The notion that local businesses are destroyed by interstate competition reflects the dangerous protectionist sentiment that has been explicitly rejected in connection with the dormant commerce clause, where efforts of local governments to protect their industries have widely been condemned as an interference with the competitive processes of a common national market.[12] It is also too narrowly focused on the job market in states to which goods are sent, while ignoring any improvements in local job markets in the states from which these goods have been shipped.

Worse still, comparisons to the Sherman and Clayton Acts are off the mark. The effort of these two statutes to control monopoly practices and to restrict mergers that might substantially lessen competition are perfectly consistent with the proposition that competitive markets out-produce monopoly ones. To the extent that the familiar "unfair competition" language is read to prevent the use

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[11] *Darby*, 312 U.S. at 122 (citations omitted).
[12] See, e.g., *Dean Milk v. City of Madison*, 340 U.S. 349 (1951).

of force and fraud in markets, it also meets that same standard in the context of consumer welfare. Nonetheless, it utterly fails to meet that outcome when it proposes to put substantive limitations on the terms and conditions under which goods and services are sold in competitive markets—a point which was clearly recognized by Chief Justice Hughes in the 1935 decision *ALA Schechter Poultry v. United States*, [13] which denied these claims for unfair competition. Regulation is permissible to prevent monopoly power. But it is utterly misguided when used to suppress competition in cases where force, fraud or misappropriation are not present.

In my view, the correct constitutional answer lies in *Schechter* and not in the many cases that have overruled it. This study of the FLSA aims to establish that this general proposition is supported by a close examination of the particular cases. One common refrain is that these New Deal interferences with freedom of contract made economic sense at the time of their introduction when the modes of production were vastly different from what they are today. I take issue with that rosy formulation. To the contrary, as this theoretical and historical analysis shows, these legislative interferences never served any useful function in labor markets. Therefore, their saving grace, if any, was that the level of dislocation was smaller in the labor markets of the 1930s through 1960s than today for the simple reason that hourly workers comprised a smaller portion of the economy a generation ago as compared to today. But as a theoretical matter, these differences only show that the social losses may have been smaller at an earlier time for any given firm than they would be today. But even that conclusion is up for grabs, given that the statutory innovations

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[13] *A. L. A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 531-32 (1935). The Act does not define "fair competition." "Unfair competition," as known to the common law, is a limited concept. Primarily, and strictly, it relates to the palming off of one's goods as those of a rival trader. In recent years, its scope has been extended. It has been held to apply to misappropriation as well as misrepresentation, to the selling of another's goods as one's own, — to misappropriation of what equitably belongs to a competitor. Unfairness in competition has been predicated of acts which lie outside the ordinary course of business and are tainted by fraud, or coercion, or conduct otherwise prohibited by law.

impacted a far larger fraction of the economy then than they do today. But for this occasion, the key conclusion remains that for both periods, these rules have failed to provide any positive social benefits at all.

To make out this case, I proceed as follows. Section 1 sets out the analytical framework which uses the transaction cost analysis pioneered by Ronald Coase to explain the sharp contrast between the way in which markets and regulators deal with ideal types—in this instance, the definition of an hour or an employer. Then in Section II, I address the early history of the regulatory hour, and the difficulties associated with the definition of an employer. The first subsection deals with the definitional challenges apart from individual cases. The second subsection turns to the New York State maximum hours law at issue in *Lochner v. New York.* The third subsection in turn addresses the similar issues that arise just after the passage of the FLSA, most notably in *Skidmore v. Swift.* Section III then carries the earlier discussion to more modern applications of the FLSA and its state variants in traditional industrial contexts in connection with the multi-front war generated in California when an appellate court in *Gonzalez v. Downtown LA Motors* found the defendant employer in violation of the state FLSA when the employer attempted to apply the minimum wage law by a formula that divided total weekly wages by total hours instead of making sure that each worker received the minimum wage for each separate hour worked.

There is one striking omission here. There is a huge debate over the question of whether the minimum wage law causes an increase in unemployment levels or whether other adjustments in the terms and conditions of labor can either eliminate or reduce its impact. The debate is orthogonal to the issues discussed here because it assumes that the hour is a known and accurate measure of work effort and only asks what happens when the regulated wage is above the market clearing wage. I am generally of the view that, like other systems of price controls, the imposition of a binding constraint—e.g. where the market clearing wage is below the statutory minimum—will increase the level of unemployment. The precise level of increase will depend on the size of that gap and the elasticity of supply and demand. If that result is true, what is said here is icing on the cake. But if for some reason it were false, the case for the FLSA rules on

minimum wages and maximum hours is still heavily dependent on the mismatches discussed here and the cost of enforcement and compliance. The simple question is whether there exists any allocative improvements that justify the heavy costs on both government and private parties, many of which are set out here. The answer to that question is, I think, in the negative. And if so, the statute should be repealed or struck down as unconstitutional notwithstanding the enormous entrenched interests in favor of its enforcement. But even if that is not done, *how* the statute is applied still has, as will become evident, an enormous impact on the overall success or failure of the scheme, as these more detailed case studies show.

I. THE ANALYTICAL FRAMEWORK

In order to develop the theoretical framework for analyzing wage and hours law, I begin with Ronald Coase's 1937 article, "The Nature of the Firm," that sketches out in simple and powerful form the transaction cost considerations that help determine the preferred mode of compensation for labor, of which an hourly wage is only one component.[14] The starting point for this inquiry asks a simple question: why are there firms and not just a set of individual spot transactions whereby individuals purchase precise quantities of goods and services either as inputs for their own business activities or as consumption goods? In asking this question it is evident, from the beginning of time until the present, that any well-functioning market features both kinds of transactions in multiple variations and permutations. But it is equally clear that various business activities are not distributed randomly across the different forms of business organizations, which in turn leads to the further question of which activities take place in which institutional framework and why.

Coase's great achievement was to ask the right question in the first place, to which he gave a *partial* answer which remains part of

[14] Ronald H. Coase, *The Nature of the Firm*, 4 Economica (n.s.) 386 (1937).

any more comprehensive solution. To this day, Coase is best known for stressing the role of transaction costs in organizing social life.[15] These costs are as pervasive in dealing with legal systems as friction is in dealing with the operation of any physical system. As a descriptive matter, one central task of both law and economics is to ask how transaction costs arise and how they influence behavior. As a normative matter, the inquiry shifts to the question of what regulatory and contractual frameworks can minimize the transactions that arise, from start to finish, in any particular venture.

The basic concept that remains true is that it is very difficult for any legal system to find some *direct* metric of social welfare. There are major informational problems in understanding the subjective preferences of the relevant parties. And it is difficult for any government agency from afar to asses technical and business abilities of various parties who act either individually or as part of some joint venture. The stress on minimizing transaction costs thus becomes an *indirect* way to attack the ultimate question of how best to maximize overall social welfare. Transaction costs could equal zero only if all deals were done instantaneously—after all, time is a cost—and done with perfect knowledge by all parties, given that search costs—and hence fraud—would also be zero. That world is no more possible than one in which particles move faster than the speed of light. But it is always possible to reduce transaction costs, and the greater that reduction the more likely that benefits will occur in two dimensions. First, voluntary transactions will produce gains for the immediate parties to any transaction. Second, these transactions will in turn set up possibilities of further gains by transacting with others in the chain of production or distribution.

The basic relationship here is that between potential gains (G) to all parties and anticipated transaction costs (T) to all parties. If $G > T$, the deal will go forward with a total gain of $G - T$; if $T > G$, then it will not happen at all, at which point it becomes impossible to

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[15] Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. Econ. 1 (1960).

measure the actual losses. Legal systems are far better at dealing with transaction costs by the use of such strategies as formalities (e.g., all contracts of certain key classes—real estate, guarantees—must be in writing to be enforceable) than they are in seeking to measure gains or losses to private parties.[16] Hence, to lower T is to facilitate the deals where G gets ever smaller. It is this simple insight that drives the Coasean model. As the "Nature of the Firm" stresses, all alternative forms of business arrangements generate their own transaction costs. The optimal transactional form is that which minimizes the transaction costs needed to reach some shared business objective.

At this point, the comparisons become clear. Any discrete transaction, of which the contract for sale of a particular good is the easiest example, is not costless to put together. For starters, it has long been recognized that without a system of money a contract of sale cannot take place: after all, the definition of a sale is a contract for the transfer of ownership and possession of a thing in exchange for a monetary consideration known as the price.[17] The use of cash as a standard and measurable unit of exchange obviates the need for barter, where there has to be rough equality of value between the thing surrendered and the thing obtained. With money in circulation, A can sell a cow to B and use the proceeds to buy a horse from C. Without money, both these transactions would probably never take place. So the initial lesson is that the use of a standard unit of measurement facilitates an exchange market and thus reduces the need to gather all productive activities within a single household. It was just that household system of production that played so large a role in preindustrial days, where the combined labor of many people (often including plantation slaves) in an "extended family" allowed for a limited specialization, albeit far less than that which takes place

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[16] These are all variations of the English Statute of Frauds, 29 Car. 2 c.3 (1677), which has been adapted in some similar form everywhere into the United States.
[17] All these relationships were understood in Justinian, *Digest*, Book XVIII, Title I.

in a robust market with extensive specialization and frequent sales and other transactions. [18]

The need for cash as a medium of exchange, however, is but one element required for organizing a market. A system of prices works best as a precise measure of quality and quantity, which is why much of the early law of sale deals with fungible products—e.g. wine—which in turn allows for accurate price comparisons across sellers. It also requires some mechanism, either public or private, for the enforcement of exchanges. The easiest method to minimize enforcement problems is a simultaneous cash sale. But those simple transactions do not allow for gains from trade across the dimension of time, which can take place if either (or both) the delivery of goods or the payment of money is delayed. Nor is it possible to make loans if all transactions must be simultaneous. But with the added temporal dimension rises the risk of default, which in turn gives rise to practices that create both real or personal security. Both were very much part and parcel of the Roman law of sale, which in time was carried over into both continental and English systems of law.[19]

These arrangements seem to obey an iron law. Any effort to get gains from trade across a different dimension (time, place) increases the pressure on transactions costs, so that technological improvements that lower T may be critical to drive business arrangements. And once the costs of these spot transactions are realized, individuals may well take steps to reduce them. One way in which that can be done is to have two or more individuals in direct relationships with each other, where each individual act or transfer of property does not have a separate price tag attached to its operation. Yet, lo and behold, these more or less permanent relationships generate transaction costs of their own. Given that there are no prices to structure the deal, it becomes necessary to substitute

[18] For discussion see, e.g., Duncan Ironmonger, *Household Production*, in Neil J. Smelser and Paul B. Baltes, eds, *International Encyclopedia of the Social & Behavioral Sciences* 6934 (Elsevier Science 2001).
[19] The form of real security was called *fiducia*, on which see Gaius, *Institutes*, Book 3 §§ 60-61. Personal guarantees were an essential part of early Roman law.

some other form of monitoring in order to determine the wage or salary for particular work. And the choice between these two arrangements is itself not a matter of indifference. If production takes place in relatively defined circumstances, an hourly wage may be the optimal way to go, whereby the employer can measure time and then supervise outputs to make sure that there is no shirking on the job. What counts as an hour is far from obvious given that not every minute of working time is spent over a loom, so that breaks for rest, food, and bathrooms have to be built into the mix as well. Lest anyone think that these questions are small, the endless regulations under the Fair Labor Standards Act, discussed at length infra, make clear the huge difficulties in using this system both as a matter of contract *and* as a matter of regulation.

It follows, moreover, that in some instances the effort to compensate by time becomes all too difficult, which is why most professionals, executives, administrators, and, yes, even the venerable academics are compensated by an annual or weekly salary, coupled with some overall estimation of productivity, but with no effort to keep track of hours. But here too there is no universal solvent for the same law professor who draws annual salary from some loosely defined set of expectations on teaching, scholarship, and citizenship, and who is also usually compensated by the hour or fraction thereof for various kinds of consulting work for firms, unless of course there is a lump sum payment for the performance of given types of work. It becomes clear that there is a constant tension between the costs of monitoring labor output and the form of compensation supplied for that labor.

These sands constantly shift. Every generalization is subject to counterexamples as the relative costs of different kinds of oversight vary with the type of labor involved and the capacity for oversight. If it is possible to measure inputs accurately, and output is part of team production, there will be a tendency to use wage contracts. But where inputs are hard to measure, the contractual form may well shift to *either* a salary contract, which relies on some global estimate of productivity, or a piecework contract that attaches a predetermined price to each individual unit of production. If in fact there is rigid control over team production, there may well be a perfect correspondence between compensation by the hour and

compensation by the piece, at which point any scheme of regulation of the former has to extend to the latter if massive evasion is to be avoided.[20] But when that lockstep progression is broken, there is *a priori* no obvious way to decide which of these methods of compensation is best in a given relationship, which is why all of these forms of business arrangements are found simultaneously in employment markets. The great strength of the market-based approach is that the law does not seek to prejudge what kind of business arrangement—or what wage terms—are best for any given transaction or business. It takes its lead from the parties and uses an elaborate set of default terms to minimize the risk of *contractual opportunism*, i.e., the effort of any party to deliver less than was promised, without loss of wages on the one side or productivity on the other. The complexity of these deals points strongly in favor of a general regime of freedom of contract in this most nascent of firms.

It is here where the limitations of Coase's original work become more evident. Firms come in all sizes and shapes. Yet it is highly unlikely that the same internal organization will apply to a firm with 2 and 10,000 workers. Indeed, vast differences can occur even between smallish firms that have only two or three members. The key point here is that the transaction cost theory as developed by Coase does not, standing alone, tell us what configuration a firm takes or why. In order to capture these factors and thus make the model more general and more powerful, it is necessary to introduce other variables.[21] The two key variables in this regard have to do with a correspondence of values on the one hand and differences or equality on matters of competence on the other. Standard economic

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[20] As recognized in *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 729 (1947), discussed infra at 26.

[21] The point has become something of a preoccupation for me. See, Richard A. Epstein, ***The Nature of the Religious Firm***, 21 *J. Markets & Morality* 141 (2018); Richard A. Epstein, *The Role of Exit Rights: What the Theory of the Firm Says About the Conduct of Brexit Negotiations*, 39 *Cardozo L. Rev.* 825 (2018); Richard A. Epstein, *Inside the Coasean Firm: Why Variations in Competence and Taste Matter*, 54 *J. Law Econ.* S41 (2012).

theory that places great stress on the rational economic man tends to play down the first of these two variables and to ignore the second entirely. But the configuration of a firm is heavily dependent on both.

The first variable—common interest—deals with the question of whether two (or more) individuals see eye to eye on the firm venture. If they have substantial differences in their estimations of what products the market wants or how best to achieve it, the best result is for the two (or more) individuals to go their separate ways in order to avoid conflicts in planning, product design and financing that are always sure to crop up down the road. Ironing out differences is expensive and the ultimate product could easily be something to which none of the parties are deeply committed, at which point the ability to continue firm operations through thick and thin is severely compromised. It is for this reason that many small firms involve the combination of parent and children or siblings. This natural advantage does not mean that these small groups always work well. But it is the case that the relevant parties have sufficient information about everyone else's preferences and competences that makes it more likely that they will both have common values and will have knowledge of each other to make the venture work. Of course, a familial relationship is not an absolute requirement and many a fine partnership—Apple, Hewlett-Packard, Google—started with high school and college friends. But what makes all successful firms work is a sense of complementarity in both skills and objectives. That alignment of interests reduces monitoring costs and thus gives this firm a comparative advantage over other organizations in which that trust element is not present.

The second variable—competence—is every bit as important. To be sure, conventional wisdom tends to address these matters only in cases of extremes. Much of medical ethics is consumed with the question of what should be done to help people who are faced with serious competence issues that often come at the same time as mounting medical problems. These stark contrasts prompt a variety of devices to overcome the gap: advanced directives and various guardianship arrangements are perhaps the two most common. But these differences in competence are evident everywhere in ordinary life, even at a far less dramatic level. And firm organization responds to them as well.

The first intuition is that the greater risk is placed on that individual or those individuals who have greater all-round competence in running the business of the firm. The simple point is that the incentives are best aligned when that person is made into the "residual claimant," and thus only makes a profit when all others in the firm have been satisfied first. The use of this system bears close resemblance to the debt/equity distinction common in financial arrangements, where the split is put into place for the same reason. The better monitor takes the larger risk, and both parties are left better off than before.

Yet it is in the systematic application of this core principle that the complexities often begin. In a two-party firm, the first approximation is that we have either two partners or one employer and one employee. In a three-party arrangement the permutations are more numerous. One simple arrangement is to have three equal partners. Another is to have two partners and one employee. Another is to have one owner and two employees. But further permutations are possible. The partners may not have equal stakes, nor need they have identical priorities on draws, nor need they only contribute cash as opposed to other assets or a promise of labor. Employees may in most cases receive fixed salaries, but in some cases it makes perfectly good sense to transfer some portion of the risk position to them so that they take a lower base pay but receive a commission based the business that they generate for the firm, which could in turn be divided several ways. Hence the simple up-down division of control can be replicated by mixed devices for which the private knowledge of the firm dominates the external knowledge of any regulator. And these wage divisions can be complicated further by additional benefits or perks that deal with such matters as training, vacation, bonuses, promotion or demotion, health and retirement, and much more. Some of these may be subject to institutionalized agreements at the outset, but others are developed over time when the operations within the business give the relevant players better information on how these relationships should be structured.

It follows therefore that only one of two results could happen. The first, which is highly unlikely, is that the regulation does not constrain any of the allocation schemes desired by the firm. Yet even if the wages or benefits given are left untouched, reporting and other

compliance costs could impose a financial drag on the firm. But the more likely outcome is that the constraints will pinch substantively, so that the parties will necessarily be placed in a second-best world where they must ask the question of what variations in the basic business structure, salary or benefit packages should be made to minimize those dislocations resulting from regulatory enforcement. At this point the number of relevant variables necessarily increases, so that the likelihood of errors is necessarily compounded as well. So long as wages are offered in competitive markets so that entry and exit remain operative, it is highly unlikely that any regulator can find some golden measurement that will outperform what the firm does for itself. The common charges of unequal bargaining power owing to differential wealth, which underlie both the NLRA and the FLSA, ring hollow when competitive market forces constrain the options to the firm, and of course to the workers as well. These theories make it impossible to explain how rising productivity can lead to increased wages, which is the usual story across all labor markets.

II. A HISTORY OF THE REGULATORY HOUR

A. A MATTER OF DEFINITIONS

The basic schemata developed above works not only with abstractions but is illustrated quite simply by looking at the way in which wage and overtime regulation are tied to one simple notion (so-called) of immense complexity, which is the *hour* of work *by an employee* as the basic measurement of the productivity. Everyone knows exactly who is covered by this term—but only until they try to formalize the definition, at which point the ambiguities quickly arise. For starters, the FLSA defines an "employee" as "any individual employed by an employer,"[22] to which it then helpfully adds the following caveat: "An entity 'employs' an individual under the FLSA" if it "suffer[s] or permit[s] that individual to work.'"[23] The

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[22] 29 U.S.C. § 203(e)(1).
[23] 29 U.S.C. § 203(g).

obvious point of reference for these determinations is of course the common law rules, which were often fashioned in different times and for different purposes. The carryover therefore is imperfect and the Supreme Court, always fond of hedging its intellectual bets, has warned that the FLSA "stretches the meaning of 'employee' to cover some parties who might not qualify as such under a strict application of traditional agency law principles."[24] That definitional provision has real bite only to the extent of its explicit exceptions. Hence the importance of the distinction between an employee and an independent contractor, or, more recently, the distinction between an employee and a student.

In dealing with statutes, coverage provisions should all have bright lines so that people know whether they are in or out. That is just not possible with the FLSA. As noted earlier, contractual innovations take place along the following lines: People start with clear awareness between different kinds of contracts. So every knows the difference between a sale and a rental—until the complications set in. This problem was well understood under Roman law, as evidenced by the cases which struggled with the line between sale and hire. One classic example involves a simple contract where the owner of gladiators gives them to someone else for an exhibition on the following terms:[25] so much for each gladiator who is returned alive—i.e. a contract of hire, but much more for those who are killed—a contract of sale. It looks like a nifty solution, except for two difficulties. First, which action should be brought if the gladiators are *not* delivered, and second, what happens if some gladiators live and others do not. Which action is appropriate prior to performance? And post-performance, must there be two forms of action?

By way of historical curiosity, Rule One of the Federal Rules of Civil Procedure stated in 1938 that there shall be only one form of action, precisely to avoid these difficulties. Yet the FSLA, adopted in

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[24] *Nationwide Mutual Insurance v. Darden*, 503 U.S. 318, 326 (1992).
[25] Gaius, *Institutes*, Book III, § 146.

that same year, tries to separate the many variations on basic contract terms into different classes. There was always an awareness that this classification problem would arise, and the early cases took the resigned position that administrators and courts could sort them out one at a time. Thus in *Rutherford Food Corp. v. McComb*:[26]

> As in the National Labor Relations Act and the Social Security Act, there is in the Fair Labor Standards Act no definition that solves problems as to the limits of the employer-employee relationship under the Act . . . . We have said that the Act included those who are compensated on a piece rate basis. We have accepted a stipulation that station "redcaps" were railroad employees. There may be independent contractors who take part in production or distribution who would alone be responsible for the wages and hours of their own employees. We conclude, however, that these meat boners are not independent contractors. We agree with the Circuit Court of Appeals, quoted above, in its characterization of their work as a part of the integrated unit of production under such circumstances that the workers performing the task were employees of the establishment. Where the work done, in its essence, follows the usual path of an employee, putting on an "independent contractor" label does not take the worker from the protection of the Act.[27]

There is nothing odd or perverse in this effort to mark out the boundaries of a statutory term by the process of inclusion and exclusion. But by the same token, this preoccupation with the narrow statutory task of classification necessarily puts to one side the two questions that ultimately matter the most: What are the incentive effects of the new rule on the various parties as they seek to organize their own business arrangements? And if there are effects, does any theory explain how various applications of the FLSA advance social

[26] *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 67 S. Ct. 1473 (1947).
[27] Id at 728–729 (citations omitted).

welfare? These questions are largely pushed under the rug. But the analysis becomes more pressing by taking a closer look at some of the key landmarks in this particular inquiry, for there are many cases in which the use of the hour as a model of compensation does not work. The Supreme Court has noted that piece rate workers fall into *Darby's* effort to prevent substandard wages, for it would create too large a gap in coverage to exclude them entirely.[28] But there was no explanation as to how to make the needed conversions from the contractual to the regulatory standard in the cases where they are not highly correlated. This problem looms only larger as time progresses. It is therefore useful to review some of the history to show how an apparently small glitch in the statutory scheme generates larger problems.

This history of the hour begins with the rise of the progressive era, when the wage and hour laws enacted were sometimes upended by constitutional challenges, but often not. The argument I am developing here does not reject the use of the hour in voluntary arrangements, where it may well be preferable to all other alternatives. That situation is likely to arise in businesses that work in fixed locations on regular shifts, where workers are to punch a time clock in and out to get an accurate measure. Typically, many workers will be subject to the same regime, and the use of assembly lines or other production techniques means that all workers perform to roughly the same level. The hour thus becomes a powerful tool for preserving equity among workers.

The simplest explanation for the use of the hour in systems of regulation is that—piece rate work aside—it tracks, at least to a degree, the use of the same measure by private parties in their own affairs. The implicit assumption in both of these cases is that the hour is a sufficiently stable and homogenous measure, such that total effort can be best measured by taking a constant wage and multiplying it by the number of hours worked. That standard does not necessarily imply that all work hours are exactly identical—even

[28] *United States v. Rosenwasser*, 323 U.S. 360 (1945).

if that is the easiest measure. Instead it assumes that the number of hours is frequent, and that the variation among them is either cyclical or sufficiently low, or both, such that averaging out the small bumps and valleys gives a composite number that is more reliable than any more complex index.

These conditions were commonly satisfied in the great automobile plants and factories that were commonplace in the 1930s when the FLSA was passed. But in voluntary markets, the method of compensation will vary as a function of local circumstances, which regulators find difficult to pick up at a distance. At this point, the hour becomes a useful means of wage standardization. That standardization ensures that all parties know what is owed, and it helps give workers some needed assurance that other individuals doing the same job do not get some undeserved advantage, which can spark deep animosities among coworkers, whose reference point for comparison is their immediate coworkers and not some further removed rich person.[29]

This general proposition is subject to an important caveat: Over long periods of time, fatigue can set in, which is why both private firms typically offer, and government regulators always require, some bonus—commonly set at time-and-a-half—for overtime work. In addition, certain shifts involve work on weekends and holidays, where the opportunity cost of not working is higher and the homogeneity assumption often fails. These mismatches matter.

It is one thing, however, for a firm to adopt the hour as the unit of accounting, and quite another for the government to impose that identical standard. As a first approximation, the hour may, and often does, work well, and when it does the firm will keep it for the sake of simplicity and parity. But in those cases where the measure does not work, the firm can make adjustments in the compensation formula far more quickly and precisely than any government regulator. The earlier discussion showed that there are many intermediate positions between equity ownership and a fixed wage,

[29] See Truman Bewley, *Why Wages Don't Fall During a Recession* 310 (1999).

of which bonuses, and in-kind perks on the plus side, and fines, demotions, suspensions and dismissal on the negative side constitute only some of the most common variations. The firm that includes these benefits needs only to secure the consent of both sides. And it will do so when the hour is not a fully accurate unit of account. The government that must respond to these new compensation practices has to decide whether, and if so how much, they count against a minimum wage or overtime requirement, given that the statutory definition of an hour becomes the sole unit of accounting for purposes of regulation. Then it remains in place until a collective decision is made to upend that standard, which is a far longer and more torturous process than unilateral decisions by a firm to alter the unit of account consistent with its contractual obligations. Even before the rise of the gig economy it is possible to identify important situations in which both of these assumptions do not work. Sometimes the assumption of rough homogeneity among hours leads to serious distortions, as do the usual multiples for overtime wages. Clearly these measures would have never survived if they failed more or less across the board. But the cases that do challenge the mold are of enormous consequence, and it is useful to review some of those cases here.

B. LOCHNER V NEW YORK

One of the most famous (and vilified) cases in the constitutional law canon is *Lochner v. New York*,[30] where a sharply divided Supreme Court (5 to 4) struck down New York's maximum hours law that restricted employment to 60 hours per week and 10 hours per day. The New York law contained both a distributional cap and an aggregate limit. There is little doubt that the hours involved were long, and in general even at the time were more or less outside the standard norm. The battle over the case took place on two fronts. The first question was whether any restriction on hours was a violation

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[30] *Lochner v. New York*, 198 U.S. 45 (1905).

of the liberty, or freedom, of contract, that was said to be protected against state regulation under the Due Process Clause of the Fourteenth Amendment, which already had been answered in the affirmative in *Allgeyer v. Louisiana.*[31] The second question was whether the infringement of liberty, assuming it to be covered, fell within the scope of the police power, which operates as an implied limitation on the liberties protected under the Fourteenth Amendment in order to protect the public "health, safety, morals or general welfare" of the public at large.[32] There was no dispute in *Lochner* that the police power imposed sharp limitations on any claims for individual liberty. In this instance, morals and the general welfare dropped out, while health and safety in the case of factory conditions tended to merge. In this regard, dangerous exposures could make, for example, maximum hours legislation a better candidate for police power justification than a minimum wage law that is at least one degree further removed from any concern with health and safety. But even these could not, as Justice Rufus Peckham rightly insisted, be so elastic as to swallow all claims for contractual freedom.[33]

On the other side of the line, there were two types of statutes. The first of these was paternalist, where the government sought to substitute its judgment for that of the individual worker about the riskiness of different levels of exposure to workplace perils—a risk which was at the time a staple of industrial life. The second was whether the maximum-hours law could be attacked as an impermissible "labor" statute, i.e. one that had the intent and effect of suppressing competition between different kinds of workers and different kinds of firms. The question was where to draw the constitutional lines in the face of all these conflicting rationales.

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[31] *Allgeyer v. Louisiana*, 165 U.S. 578 (1897).
[32] *Lochner*, 198 U.S. at 53.
[33] See id at 57.

Within common systems of regulation, 60 hours seems a generous allowance, which should count as a strong chip for finding the regulation reasonable. But here much turns on the type of hours covered by the regulation. A hint that something is amiss comes from reading the full New York statute, the last subsection of which contains the maximum hours provision.[34] The prior subsection provides that the employer must employ adequate ventilation for sleeping quarters.[35] That one provision is the clue to undermining the health and safety rationales in this case, even though it might leave other such cases unaffected.

So why this provision? The answer is that there were two business plans for making bread in New York State. The practice of the unionized shops was to employ two shifts of workers, one to prepare and bake the bread on the evening, and the second to collect and package the loaves after they were baked. Each of the two independent work teams easily fits under the 10-hour maximum. But the same was not true of the nonunion bakers who were their direct competition. These workers had a far longer day. They baked bread at night; slept in their sleeping quarters; and then rose to collect and prepare the finished loaves for distribution. So their day was well over the 10-hour limit. Hence the statute had a huge disparate impact between two rival forms of production. The adequate ventilation provision was left unchallenged, even though it could have been an unduly burdensome form of regulation, used to raise rival costs of production. But the maximum hour provision had two related effects. First, it disrupted a form of production that met with the approval of both the firm and its workers. Recall that *Lochner* was a criminal prosecution, not an action for personal injury or lost wages by the workers. The second is that the time spent by the workers outside the plant did not carry anything close to the same risk that was borne by the workers while under the plant floor, so that the implicit

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[34] See New York Labor Laws, N.Y. Lab. Law § 160-70 (McKinney).

[35] Id. For discussion, see David Bernstein, *Rehabilitating Lochner: Defending Individual Rights Against Progressive Reform* (2011).

assumption of homogeneity of working hours was incorrect, and radically so.

All police power cases involve some kind of balancing act, and here as both variables move in harmony, it should be clear that striking down the New York maximum hour law on the grounds that it was paternalist, or anticompetitive, or indeed both, looks much more powerful when the full context is taken into account. It also means that this case is distinguishable from those cases like *Holden v. Hardy*,[36] which imposed maximum hour limitations on work in mines and smelters, where the normal assumptions that each additional hour past a certain point has more deleterious effects gains plausibility. It is possible of course to argue that assumption of risk should govern all these cases on the grounds that workers were sufficiently apprised of the relevant risks because of their deep familiarity with working conditions. But that view of assumption of risk had already been rejected constitutionally during this period,[37] so that the reasonableness of the risk assumed tied into the earlier police power discussion. And it is precisely because all hours are not created equal that explains the outcome of *Lochner*, whose significance for constitutional theory can hardly be ignored.

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[36] *Holden v. Hardy*, 169 U.S. 366 (1898).

[37] See *Mondou v. New York, N.H. & H.R. Co.*, 223 U.S. 1 (1912) (Van Devanter, J. for a unanimous court) (upholding the Employers' Liability Act of April 22, 1908, 35 Stat. 65, c. 149, as amended April 5, 1910, 36 Stat. 291, c. 143, against constitutional challenge based on the then interpretation of the Commerce Clause. Section 5 of the FELA explicitly barred the assumption of risk defense) However, a challenge on that ground was summarily rejected, 223 U.S. at 52. "If Congress possesses the power to impose that liability, which we here hold that it does, it also possesses the power to insure its efficacy by prohibiting any contract, rule, regulation, or device in evasion of it." An earlier version of the statute was struck down in *Howard v. Illinois Cent. R. Co.*, 207 U.S. 463 (1907) (Chief Justice White writing for a divided court).

C. SKIDMORE V. SWIFT & CO.

United States v. Darby[38] was a triumphant march in support of the power of the federal government to "protect" workers from the excessive economic power of employers. But the difficulties in its application came to the fore three years later in *Skidmore v. Swift & Co.*[39], which arose out of the following firm practice. The workers put in a regular eight-hour day, after which they remained on the employer's premises in a fire hall throughout the night for three-and one-half or four nights per week. They did not receive any pay for the time that they were in residence, during which time they had the option to sleep, play pool or dominoes, or listen to the radio in quarters that were both steam-heated and air-conditioned. The workers also received extra pay for those occasions on which they were required to answer alarms, which occurred rarely.

The workers claimed that they were entitled to overtime pay for the full time that they were on the premises. However, the Court of Appeals for the Fifth Circuit held that the Fair Labor Standards Act did not apply when these workers remained on the premises, except when they were called out to answer the alarm.[40] Its explanation went as follows:

> The mere fact that a servant has agreed to live on the place does not justify the conclusion that he is engaged in commerce even though his employer may be. One must sleep whether at home or abroad, nor is he at work when he is asleep. The vice of long hours of toil is not present here. The employees worked eight hours during the day and rested, relaxed, played, or slept on nights in the hall according to the pleasure of each.[41]

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[38] *United States v. Darby*, 312 U.S. 100 (1941).
[39] *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).
[40] *Skidmore v. Swift & Co.*, 136 F.2d 112 (5th Cir. 1943) rev'd, 323 U.S. 134 (1944).
[41] Id at 113.

Even if the plaintiffs had been entitled to recover for hours spent in boredom, or waiting for bedtime, or an alarm, the proof wholly fails to delineate the actual hours spent either in sleeping, playing pool, dominoes, or radio, dressing, shaving, bathing, or in any of said enterprises, the burden of which was on the plaintiffs.[42]

The Fifth Circuit did not perform any close economic analysis of the situation, but its instincts led them to realize that the FLSA just did not fit the case. The implicit statutory assumption is that overtime involves constant and strenuous work at the end of a long day, which becomes riskier as fatigue sets in. But in this case that assumption did not hold, so that the pre-FLSA wage package accurately reflected the underlying business realities. Indeed, the Fifth Circuit noted that "The vice of long hours of toil is not present here."[43] For the time they spent in the facility, the workers received no explicit cash compensation, but they did get the benefits of all the amenities of staying in the fire hall, which were of course not taken into account as compensation under the FLSA. Yet when they had to work, they did receive explicit compensation for their extra effort. Hence it looks as though this two-tier contract was efficient in form precisely because it had wages track both effort and productivity for workers in this idiosyncratic situation.

Nonetheless, the Fifth Circuit stumbled on the question of whether hours sleeping should be treated differently from hours awake playing games or listening to the radio. As an economic matter, the employer did not stipulate or care how the workers divided their time between these activities, and we can assume that the employees split their time so that at the margin they got the same benefit from both kinds of activities. Since the employer was indifferent to the allocation, the sensible thing is to make no distinction between the two kinds of activities in setting pays scales, and exclude protection of the FLSA from both. That conclusion was imperfectly reached by the Fifth Circuit, but only through an

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[42] Id.
[43] Id.

evidentiary dodge. Since in making their case the plaintiffs did not "segregate" out their time for the different activities, the issue was treated as moot, even though a respectable outcome would have been to remand the case to allow the plaintiff to introduce evidence to repair the gaps in the proof—assuming that anyone actually kept track of the time spent in the two activities.

When the case came to the Supreme Court, the decision was reversed in an opinion of Justice Robert Jackson on the ground that "we hold that no principle of law found either in the statute or in Court decisions precludes waiting time from also being working time. We have not attempted to, and we cannot, lay down a legal formula to resolve cases so varied in their facts as are the many situations in which employment involves waiting time." [44] At this point the economic analysis developed above played no role in the case. Instead, the court took the view that the creation of the administrative agency meant that these hard questions were for the most part to be discharged with reference to the experience of the administrator, based on his or her ability to collect and examine information across multiple cases and areas. In this case the administrator held that no hard and fast rule applied, so that all facts and circumstances had to be taken into account. As is common in this kind of case, administrators give particular examples which never quite cover the case before the court. Nonetheless, in what has now become known as *Skidmore* deference the court concluded "the general tests which he has suggested point to the exclusion of sleeping and eating time of these employees from the workweek and the inclusion of all other on-call time."[45] After all, "there is nothing in the record to suggest that, even though pleasurably spent, it was spent in the ways the men would have chosen had they been free to do so."[46] At this point, the court held that these rulings are entitled

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[44] *Skidmore v. Swift & Co.*, 323 U.S. 134, 136 (1944).
[45] Id at 139.
[46] Id.

to some deference even though they were not made in any kind of adversarial hearing, such that it takes "very good reasons"[47] to set them aside.

It is at just this point that the entire administrative law approach breaks down, for the Court gave no substantive analysis whatsoever on the fit between the overtime provisions of the FLSA and the burdens borne by the worker. The distinction between the two kinds of activities is wholly unprincipled and will have the undesirable effect of inducing workers to stay awake to collect overtime pay in ways that the employer cannot possibly combat: what employer can order its workers to sleep a minimum number of hours per day? Nor is it clear that this accommodation can survive a small tweak in the overall compensation system. Thus suppose that Swift found that it could attract a better class of workers if it paid them $1.00 per hour for the time that they were in the fire hall whether they slept or played. At this point, it seems easy to hold that the explicit decision to pay compensation meant that all these hours were covered by the FLSA overtime provisions, so that full compensation is due. The economics of the situation demand, however, the exact opposite result. The correct way to think about this problem is to note that the wage differential is intended boost the overall compensation levels without undermining the distinction between the time that the workers were idle and the time that they were answering alarms. This boost in total compensation might well prove more efficient than the previous regime in which all compensation came in the form of in-kind benefits. But the financial penalty for the employer would have been ruinous, because the low payment would be treated as a concession that these workers were employed all the time that they were in the fire house, so that time-and-a-half would be the required payment for each hour. It should be clear that in this situation the bad fit between the FLSA's generic overtime provisions and workplace imperatives leads to massive resource distortions that

[47] Id at 140.

could easily play out with huge losses, as indeed has proven the case in other contexts.

Ironically, we do not know from the opinion whether *Skidmore's* particular employment relationship survived this judicial application of the FLSA. But it does appear at least likely that the employer would shift to some different system whereby workers remained on call while staying safely at home. But under that regime, some workers would drop off while the response time to alarm could easily have been increased. The one point that is clear is that Justice Jackson had no substantive inkling on how to apply the FLSA overtime provisions to aberrant situations. And indeed, this issue has huge implications for the wage structure that ran afoul of California's minimum wage law in *Gonzalez v. Downtown LA Motors,* discussed shortly.

What makes the prognosis so grim is how little progress there has been on any of these salient issues in the 80 years that the FLSA has been in place. Thus a look at "Fact Sheet #22: Hours Worked Under the Fair Labor Standards Act (FLSA)[48] reveals the ad hoc nature of the rules:

> **Waiting Time**: Whether waiting time is hours worked under the Act depends upon the particular circumstances. Generally, the facts may show that the employee was engaged to wait (which is work time) or the facts may show that the employee was waiting to be engaged (which is not work time). For example, a secretary who reads a book while waiting for dictation or a fireman who plays checkers while waiting for an alarm is working during such periods of inactivity. These employees have been "engaged to wait."
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> **On-Call Time**: An employee who is required to remain on call on the employer's premises is working while "on call."

[48] U.S. Department of Labor: Wage and Hour Division, *Fact Sheet # 22: Hours Worked Under the Fair Labor Standards Act (FLSA)* (July 2008), archived at https://perma.cc/M8V6-XBM2.

> An employee who is required to remain on call at home, or who is allowed to leave a message where he/she can be reached, is not working (in most cases) while on call.

The Department of Labor Fact Sheet then makes additional problematic adjustments to deal with "Rest and Meal Periods", "Sleeping Time and Certain Other Activities," "Lectures, Meetings and Training Programs," "Travel Time," "Home to Work Travel," "Home to Work on a Special One Day Assignment to Another City," "Travel That is All in a Day's Work," and "Travel Away from Home Community." It is easy, but unfair, to criticize these rules on the ground of their inherent ambiguity. There is no evidence, given the command of the FLSA, that these particular regulations are meant to undermine a statute that they find so difficult to apply. Even firms that do not face any question of overtime requirements for salaried employees routinely have to face the same issues, and typically, they only have the same verbal tools to deal with them, which they do by some combination of general statement and customary adjustments in the light of further experience.

No, the real sticking point lies in the anterior question of why there is a need for some collectively imposed standard at all. This objection is not to firms that follow standard industry practice when it fits their needs. It is to the notion that state compulsion adds anything instructive to the mix when it works to force atypical jobs, such as those in *Skidmore*, into Procrustean beds that do not fit to their liking. That rigidity makes it harder to have incremental adjustments of customary terms to better adapt the contract to the workplace. And it also means that all the facts and circumstances of individual cases need government instruction for their solution. The added administrative expenses of government serve only to produce wage and compensation packages that are not tailored to the needs of any particular workplace. In consequence, they are less efficient and more costly than the private solutions which could be generated by the variety of devices that are already available to private firms. The social costs of these regulations are hard to measure, because it turns on the different levels of efficiency between the legal norm and the preferred private practice, which will routinely vary across firms and industries. But as times move forward it often happens that the costs

that start out within the workplace carry political ramifications which go far beyond the particular dispute.

III. THE MODERN FLSA CASES

A. GONZALEZ V. DOWNTOWN LA MOTORS, LP

The key problem in *Skidmore* concerned this structural challenge: How does the intensity and value of labor fit into the FLSA? The wrong answer to that question had dramatic implications not only under the FLSA, but also in the key California case of *Gonzalez v. Downtown LA Motors*,[49] where applicable California regulations read as follows: "Every employer shall pay to each employee, on the established payday for the period involved, not less than the applicable minimum wage for all hours worked in the payroll period, whether the remuneration is measured by time, piece, commission, or otherwise."[50] The phrase "hours worked" is defined in subdivision 2(K) of the wage order as "the time during which an employee is subject to the control of an employer."[51] That phrase includes any time the employee is suffered or permitted to work, whether or not required to do so. On January 29, 2002 the California Division of Labor Standards Enforcement (DLSE) issued an opinion letter in which it said that the phrase "all hours worked," carried with it the implication that the minimum wage was calculated separately for each hour worked, so that the employer was not able over the course of a week or month to set off pay in excess of the minimum wage for some hours, against the payment of sums below the minimum wage in other hours, even if the total pay per week or month, divided by the total number of hours worked, was in excess of the minimum wage.[52] This interpretation of the California statute came before the California Court of Appeals in *Gonzalez*, where its decision in favor

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[49] *Gonzalez v. Downtown L.A. Motors, L.P.*, 215 Cal. App. 4th 36 (Cal. Ct. App. 2013).
[50] Cal. Code Regs., tit. 8, § 11040, subd. 4(B).
[51] Cal. Code Regs., tit. 8, § 11040, subd. 2(K).
[52] *Gonzalez*, 215 Cal. App. 4th at 46.

of the plaintiffs has led to an ongoing legislative, judicial and political struggle that has yet to resolve itself.

The question before the California Court of Appeals in *Gonzalez* was how these requirements applied in the following circumstances. With shades of *Swift*, plaintiffs in *Gonzalez* were employees of DTLA [Downtown Los Angeles] Motors who performed two different types of functions at two different rates. They received a higher salary, "flag rate" compensation, when they performed as skilled technicians, but a far lower rate, which was below the state minimum wage, during those slack times when they performed more menial "waiting time" tasks like cleaning up the shop or driving cars to customers.[53] The proportions of the two kinds of task were uncertain, so that DTLA Motors also agreed in its collective bargaining agreement with Gonzalez's union that it would top off the pay packet in slow waiting time periods so that for no pay period did the average pay for the workers fall below the state required minimum wage. In effect, the employer adopted a two-stage compensation system that reflected the marginal productivity of the work, and then made the minimal adjustment needed to keep the total compensation package above the statutory minimum.

The California Court of Appeals rejected this scheme by reaching two conclusions. First, it held that the "plain meaning" of the statute required minimum wage to be paid in each and every hour, so that the DTLA was in breach of its statutory obligation to every employee in the class every month that this practice lasted.[54] Second, it found that the violations of the statute in question were willful, such that a penalty was additionally appropriate.[55] More concretely, it found that, on average, each employee had 1.85 hours per day of waiting time, which in turn meant that each of these workers were underpaid by $27.76 per day. In the end, members of the plaintiff class received

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[53] See id at 43.
[54] Id at 48–49.
[55] Id at 54–55.

some $553,653 in compensation for their waiting time, to which the Court tacked on a penalty for willful violation of $237,840, (or 43 percent) under Labor Code section 203, subdivision (a) for DTLA Motor's willful failure to pay all wages owed them at the time their employment was terminated. It was clear that this holding applied to any and all businesses that used any two-part system.[56] But how sound is the result?

The initial point to note is that the Court did not once mention that in economic terms this scheme made perfectly good sense. Higher wages for more specialized work is appropriate in every context, and is surely appropriate in this one as well. It gives workers incentives to do high paid work, but does not leave them high and dry when they do not. It seems clear that this scheme (less the final topping off provision) could easily be adopted by firms in competitive markets that have no minimum wage law.

Why then displace the result? Here the California court insisted that the matter was one that dealt with the plain language of the statute because the wage order applied whether or not the workers were compensated on a piece rate basis. That last point is correct, but it does not answer in any way, shape, or form whether the offsets should be allowed for the above-minimum wage earned while working flag hours. In order to avoid this difficulty, the Court first resorted to the presumption that the state's wages and hour laws should be "liberally construed in favor of protecting workers," without realizing that this presumption is wholly unnecessary if the plain language rule carried the day. Yet it is very hard to credit any theory of worker exploitation, when the contract in question was negotiated by a union in the course of its collective bargaining negotiations. It is also likely that if the two-tier system were rejected, the employer, at some cost to economic efficiency, would have altered its compensation formula by raising the waiting time compensation and lowering the flag time compensation. It follows

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[56] Id.

therefore that these cases—and there are others[57] —result in systematic overcompensation for workers even under the minimum wage standard.

Worse still, *Gonzalez* fails as a matter of statutory interpretation, for there is nothing whatsoever in the words "all hours" worked that carries this implication, given that the minimum wage is met for all hours if the offset is allowed. To fortify its result, the court in *Gonzalez* claimed that a similar question had been resolved in the opposite direction under the FLSA, in which the statutory language referred to employees who "in any work week" are engaged in commerce.[58] But it offers no explanation as to why the identical economic logic does not lead to the same result in both cases. Even worse still, its opinion totally misread the federal case on which it relies: *Medrano v. D'Arrigo Brothers Co*.[59] To be sure, *Medrano* was brought in federal court, as the final result depended in part on the application of the Federal Migrant and Seasonal Agriculture Worker Protection Act (AWPA)[60] which imposed obligations on all agricultural employers to keep accurate records of the hours worked so that they could properly pay their workers when the accounts were due.[61] But the AWPA in this instance was applied in connection with the *California* labor statutes that contained the "all hours worked" language. It referred to two key pieces of California law, Wage Order NO. 14-80,

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[57] Thus in *Cardenas v. McLane Food Services, Inc.*, 796 F. Supp. 2d 1246, 1251 (C.D. Cal. 2011), the Court found a violation under California state law when the wages for plaintiff drivers were calculated on the basis of miles, stops, and number of products shipped, without any explicit compensation for pre and post-shift duties, like inspections and paper work. Each hour has to be separately compensated, without the use of any offset from the high-wage to the low-wage hours. See also, *Armenta v. Osmose, Inc.* 135 Cal. App. 4th 314 (Cal. Ct. App. 2005); *As You Sow, v. Conbraco Industries*, 135 Cal. App 4th 460 (Cal. Ct. App. 2005). See also, *Bluford v. Safeway Stores, Inc.*, 216 Cal. App. 4th 864 (Cal. Ct. App. 2013).

[58] See *Cardenas v. McLane Food Services, Inc.*, 796 F. Supp. 2d 1246, 1251 (C.D. Cal. 2011).

[59] *Medrano v. D'Arrigo Bros. Co.*, 336 F. Supp. 2d 1053 (N.D. Cal. 2004).

[60] 29 U.S.C. §§ 1801, et seq.

[61] See id.

which had been issued by the California Department of Labor Standards Enforcement ("DLSE") and *Morillion v. Royal Packing Co.*[62] which had construed California's labor law provisions:

> Plaintiffs argue that [California] Wage Order No. 14-80 requires D'Arrigo to pay for *each separate hour* of mandatory waiting and travel time *regardless of how much it paid them for other work during the work period.* Neither *Morillion [v. Royal Packing Co]* nor Wage Order No. 14-80 may be read so broadly. The parties have not provided and the Court is not aware of any binding legal authority that requires an employer to calculate an employee's pay on a variable hour by hour basis. Section 4(b) of Wage Order No. 14-80 states that the employer must pay the employee on the established payday, not each hour. While *Morillion* holds that mandatory travel and waiting time must be considered part of "all hours worked," it does not hold that such hours are entitled to special status.[63]

Morillion further held that Order NO. 14-80 is not binding authority, as the DLSE had not complied with the requirements of the Administrative Procedure Act.[64] The Court in *Medrano* then noted that the differences in verbal formulation relied on in *Gonzalez* were wholly irrelevant. "Although interpreting different statutes, numerous other courts have adopted the same approach as this Court."[65] There was, in short, no precedent that suggested that the wording of the California statutory provision required or allowed a rejection of the uniform result in such cases.

If the hour compensation formula seems incorrect, the supposed finding of willful violation was all the more so. The California Court dealt a 42 percent increment for willfully failing to pay the applicable

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[62] *Morillion v. Royal Packing Co.* 995 P.2d 139 (2000).
[63] *Medrano*, 336 F. Supp. 2d at 1057–1058.
[64] Id at 1058.
[65] Id at 1058 (citing multiple federal cases).

wages. The standard for willfulness is necessarily higher than simple negligence to make appropriate adjustments in individual cases, and the applicable California law held:

> [T]o be at fault within the meaning of [section 203], the employer's refusal to pay need not be based on a deliberate evil purpose to defraud workmen of wages which the employer knows to be due. As used in section 203, "willful" merely means that the employer intentionally failed or refused to perform an act *which was required to be done.* A good faith belief in a legal defense will preclude a finding of willfulness.
>
> There is substantial evidence in the record to support an implied finding of willfulness. Although DTLA stated that its policy was to supplement its technicians' pay when flag hour compensation fell below the minimum wage floor, there was evidence that DTLA did not always follow this policy. DTLA's expert witness testified that he reviewed technicians' pay records and found instances when DTLA failed to cover shortfalls between piece-rate wages and the minimum wage floor. DTLA's failure to do so was a sufficient basis for the imposition of penalties under Labor Code section 203. The trial court accordingly did not err by awarding such penalties.[66]

The entire passage is bizarre. At the narrowest level, the defendant's expert only testified that some payments were missed. But he did not say that those misses were part of a conscious policy to refuse payment and shortchange workers. They were simple errors, which is the opposite of a deliberate refusal to perform those duties. And even if there were errors in some cases that might have been deliberate, there were no errors in all such cases, so the penalties should be applied at most in the individual cases of missed

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[66] *Gonzalez*, 215 Cal. App. 4th at 54–55.

payments—which produces a number far less than 42 percent in this case.

Worst of all, the opinion imputes willful misconduct when its own decision is a conscious and indefensible departure from prior precedent. It could hardly be willful to follow the previously standard rule applicable under the California law. But by this short sleight of hand the Court in *Gonzalez* made it all too clear that large number of employers within the state who followed the conventional minimum wage scheme faced a huge overhang of liability for back wages, penalties and attorney's fees. The novel rule provoked a furious public backlash that led to a convoluted political compromise that has yet to bring itself to a final resting place.

The basic political deal included California Labor Code, Section 226.2(a)(1), which held that all employees had to be compensated for "rest and recovery periods and other non-productive time separate from any piece-rate compensation," thus solidifying the line of court decisions that had decreed that result.[67] The legislative deal also released most employers from the obligation to pay statutory penalties and other forms of potential damages for what are termed "nonproductive work time claims," as decreed in *Gonzalez,* so long as the employers at risk paid either a flat 4 percent surcharge for all wages incurred between July 1, 2012 and December 31, 2015, or paid a sum equal to the amounts left owing under the *Gonzalez* rule plus interest.[68] About 2,110 employers took advantage of this amnesty

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[67] Cal Lab Code § 226.2(a)(1).

[68] The full provision, Section 226.2, reads:

> Notwithstanding any other statute or regulation, the employer and any other person shall have an affirmative defense to any claim or cause of action for recovery of wages, damages, liquidated damages, statutory penalties, or civil penalties, including liquidated damages pursuant to Section 1194.2, statutory penalties pursuant to Section 203, premium pay pursuant to Section 226.7, and actual damages or liquidated damages pursuant to subdivision (e) of Section 226, based solely on the employer's failure to timely pay the employee the compensation due for rest and

program, all of whom were exposed to charges of willful misconduct under the earlier precedents.

That should have put an end to the matter, but of course it did not. California is known for its intensive disputes on unionization, and two of the firms that were in union crosshairs were Fowler Packing Company and Gerawan Farming, Inc. (I consulted for several years with Gerawan on just these issues).[69] In order to avoid United Farm Workers (UFW) opposition to the compromise legislation, the sponsors agreed to "carve out" both companies (and a third grower, Delano) from the statutory safe harbor. That result was achieved in the legislation, not by naming the two companies, but by giving artificial descriptions of companies that could apply to these three firms.

Thus the California Labor Code § 226.2(g) renders any defendant ineligible for the carve out if they are subject to:

> [c]laims based on the failure to provide paid rest or recovery periods or pay for other nonproductive time for which all of the following are true:
>
> (A) The claim was asserted in a court pleading filed prior to March 1, 2014, or was asserted in an amendment to a claim that relates back to a court pleading filed prior to March 1, 2014, and the amendment or permission for amendment was filed prior to July 1, 2015.
>
> (B) The claim was asserted against a defendant named with specificity and joined as a defendant, other than as an unnamed (DOE) defendant... in the pleading referred to in subparagraph (A), or another pleading or amendment filed in the same action prior to January 1, 2015.[70]

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recovery periods and other nonproductive time for time periods prior to and including December 31, 2015 . . .

[69] *Gerawan Farming, Inc. v. Agric. Labor Relations Bd.*, 3 Cal. 5th 1118, 1133 (Cal. 2017).

[70] Cal Lab Code § 226.2(g)(2).

This provision applied to Gerawan and Delano. The statutory compromise does not point to anything wrong that Gerawan did. Its sole trigger was the suit filed against it, wholly without regard to its merits, which was coupled with a time limitation to make sure that no later firm was later swept into the class. A second carve-out from the safe harbor provision was every bit as ad hoc. It applied to any firm subject to:

> [C]laims for paid rest or recovery periods or pay for other nonproductive time that were made in any case filed prior to April 1, 2015, when the case contained by that date an allegation that the employer has intentionally stolen, diminished, or otherwise deprived employees of wages through the use of fictitious worker names or names of workers that were not actually working.[71]

Again, the statutory trigger depends solely on allegations, all of which were in complete control of the key union, and which applied only to Fowler. Truth or falsity of the allegations were again wholly irrelevant. The Gerawan and Fowler complaint alleged further that the UFW refused to support the legislative deal unless the carve-outs were made for Gerawan and Fowler in retribution for resisting UFW's unionization campaigns. A legal challenge promptly followed. The two relevant claims in the complaint alleged that the legislation amounted to an unconstitutional bill of attainder under Article I, Section 10, which states in part that "No State shall . . . pass any Bill of Attainder, . . ." and a violation of the Equal protection law for the creation of this artificial class wholly without any legitimate justification.[72] On July 7, 2016, the District Court rejected both claims on the pleadings.[73] On December 20, 2016 the Ninth Circuit on appeal in *Fowler Packing Co. v. Lanier*[74] refused to find that the ad hoc

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[71] Cal Lab Code § 226.2(g)(5).
[72] U.S. Const. Art. I, § 10.
[73] *Fowler Packing Co., Inc. v. Lanier*, 2016 WL 3648963 (ED Cal).
[74] *Fowler Packing Co., Inc. v. Lanier*, 844 F.3d 809 (9th Cir. 2016).

legislation amounted to an unconstitutional bill of attainder, because it did not impose any criminal sanctions on the defendant. But it did hold that there was good reason to accept the equal protection challenge even in the absence of some fundamental right or suspect classification. It held that even under the more forgiving rational basis test the noose was drawn tight: "Accepting Plaintiffs' allegations as true, as we must at this stage of the litigation, we can conceive of no other reason why the California legislature would choose to carve out these three employers other than to respond to the demands of a political constituent."[75] For this action, the Ninth Circuit rejected the purported justification that this carve-out (but no other) was needed "to protect expectations developed as a result of already-pending litigation and to prevent unlimited relief to employers."[76]

At this point, the jig should have been up, but as a procedural matter the Court held that the plaintiffs had "plausibly" stated a claim, and then remanded the case to the District Court for its final disposition. Since that December 20, 2016 decision, however, all movement in the case has come to a dead halt. To be sure, there are two available options. One is to strike down the statute in its entirety years after the program was put into place. The disruption is just too great. The second option is to sever the offending provisions, which would be a huge slap to the unions and the California legislature, Hence, at this point, the case looks as though it could go into permanent lock up. First, Fowler and Gerawan have either made their statutory payments or otherwise escrowed amounts to meet that obligation, if and when the District Court gets around to hearing a summary judgment motion as to the affirmative defense under AB1513. For its part, the UFW (which took credit for passage of AB1513!) would be embarrassed, whether the District Court strikes down the two ad hoc provisions while upholding the basic statutory compromise or – worse – declares that the entire statutory scheme is

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[75] Id at 815.
[76] Id.

unconstitutional. Hence, the District Court has every incentive to keep the case in limbo. California for its part would face a massive political and legal problem if the entire statute was declared unconstitutional after over two thousand employers had complied with its demands. Are they now to be exposed retroactively to extensive liability, attorney fees and penalties? The lesson here should not be forgotten: A minimum wage statute does more than set a minimum wage. It can easily set into motion a set of complex legal and political dynamics that can roil and entire industry when a strained reading of the statutory hour produces novel interpretations that upset well-established protocols, which, if changed at all, should be done only prospectively. The simple averaging provision that is applicable under the FLSA could have spared California from an ongoing nightmare that has still not run toward its final course.

B. THE HOUR IN MODERN LITIGATION

The basic theme thus far has been that even in the traditional economy the wrong account of an hour can shake any regulatory scheme to its foundation, whether it be under minimum wage, maximum hour or overtime provisions. The earlier examples show in detail the systematic dangers, both economic and political, that rise whenever the hour becomes a poor unit of accounting for productivity. The basic insight applies with even greater force to modern forms of business arrangements for which it is highly unlikely that the hour is a meaningful—let alone administrable—unit of account. The key insight remains as before. Where time is a good proxy for production, firms are likely to use the hour as a measuring rod for compensation, as they should. Hence, its appeal for assembly line work both for business and government. But if the time spent on the job cannot be monitored, as is usually the case when people are out in the field, a voluntary market is likely to shift to some sort of piecework system, simply because it is easier to monitor (by counting) the outputs than it is monitor the now unobservable inputs. There is no *a priori* form of dominance, which is why all sorts of compensation systems are simultaneously used in practice. Yet even though firms will frequently modify and switch compensation systems, the FLSA will not easily apply to all compensation systems

whether based on the hour, piece work or commission, or any variation thereof.

To see the importance of this issue, it is useful to begin with a brief account of a highly controversial question in the final year of the Obama administration, one that changed one simple number in the FLSA: What is the maximum salary to which the FLSA overtime provisions apply? In March, 2016, President Barack Obama directed then-Secretary of Labor Thomas Perez to revise the overtime regulations under the FLSA.[77] The revision's purpose was to provide overtime protections for white collar workers, given that the class of covered workers had shrunk over time because the exemption for executive, administrative, professional, computer and outside sales employees (EAP exemption) threshold had not moved up with inflation.[78] As part of its inquiry, the DOL received close to 300,000 submissions that were directed to two questions. The first point is that the worker must be paid on a so-called "salary-basis," and not an hourly basis. Hence hourly workers are *always* eligible for overtime no matter how much they are paid. As far as the FLSA is concerned, it is usually in the discretion of the firm to use either, but clearly in any labor negotiation, the choice of pay-scale will be decisive, so that hourly wages are likely to be the norm in most factory jobs, and overtime pay a fixed feature of the business environment.

Second, the "salary-level test sets by regulation the minimum salary that must be earned in order to qualify for an exemption from the FLSA." Prior to the 2016 initiative, that level was set at $23,660 per year or $455 per week. Under the proposed 2016 rule the exemption level would be raised to $47,892, or $921 per week.[79]

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[77] Tammy D. McCutchen & Libby Henninger, *President Obama Directs the Department of Labor to Revise Federal Overtime Regulations* (Littler, March 14, 2014), archived at https://perma.cc/R7YU-RWST .
[78] Id.
[79] Id.

Third, the employee must perform executive, administrative, or professional duties (the "duties test") in order to qualify for the exemption. Workers who do not fall into the exemption are eligible for overtime pay regardless of how much they make, for the exemption normally applies only if all three conditions are satisfied. But in practice, it appears that employees who salary is in excess of $100,000 per year are "most certainly exempt."[80] But notably, this judgment was not from the statute or regulations, but from a law firm with wide experience in dealing with these issues.

In May 2016, the Wage and Hour Division issued its economic impact study which did leave in place the narrow definition of the EAP exemption to the overtime requirements adopted by the Hour and Labor Division, which had previously been accepted by the Supreme Court in *Auer v. Robbins.*[81] In that case, Justice Scalia held that it was permissible for the Secretary of Labor, who at the time was Robert Reich, to refuse to treat police sergeants and lieutenants as EAPs because they are subject to certain reductions in pay for various forms of misconduct involving "variations in the quality or quantity of the work performed." [82] In effect, the provision dealt with cases where defects in production—either by quality or quantity—led to some deduction in pay, which is a good sign that work is not done by an administrator. But the use of financial penalties against officers, along with other personnel policies, is not cut from the same cloth. Nonetheless, Justice Scalia's opinion showed little respect for the expertise of the police department on matters of discipline with which they had dealt for their entire careers, nor that of the judgment of the Secretary of Labor:

> The ability to use the full range of disciplinary tools against even relatively senior law enforcement personnel is essential,

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[80] *FLSA Home Page* (Chamberlain, Kaufman & Jones, Attorneys at Law, 2007), archived at https://perma.cc/9QL4-JE5B.
[81] *Auer v. Robbins*, 519 U.S. 452 (1997).
[82] Id at 455–56, quoting 29 CFR § 541.118(a), recodified as amended at 29 CFR § 541.602(a).

> they say, to maintaining control and discipline in organizations in which human lives are on the line daily. It is far from clear, however, that only a pay deduction, and not some other form of discipline—for example, placing the offending officer on restricted duties—will have the necessary effect. Because the FLSA entrusts matters of judgment such as this to the Secretary, not the federal courts, we cannot say that the disciplinary-deduction rule is invalid as applied to law enforcement personnel.[83]

What is lost in this emphasis on the job specification is the basic hierarchical structure of police forces everywhere. *Auer* thus uses deference to ignore the simple fact that both categories of officers supervise patrolmen, and the decision was only possible because of the level of deference accorded to administrative decisions under *Chevron USA v. NRDC*.[84] Under that approach, virtually all persons in the employment hierarchy can be found eligible for overtime benefits, regardless of salary level.

To see why deference is king, test the regulatory decision against the standard job descriptions. These deliver a very different message, where they provide that a "sergeant is a field supervisor usually responsible for patrol officers," and the lieutenant "supervises the day-to-day work of a bureau, squad, or unit."[85] These activities are the very stuff of executive and administrative responsibility.[86]

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[83] *Auer*, 519 US at 459.

[84] *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984), cited in *Auer*, 519 US at 457–58.

[85] J.A. Zander, *Duties of the NYPD Ranks* (Chron, June 29, 2018), archived at https://perma.cc/QW7U-DW8R.

[86] It is doubtful that *Auer*, as understood in 1997 still represents the current state of the law. The decision was formally reaffirmed this past term in Kisor v. Wilkie, WL 2605554 (2019) by a unanimous verdict, but the construction put on the decision by Justice Kagan who wrote the main opinion cautioned that the decision applied, but first required that '[a] court must carefully consider the text, structure, history and purpose of a regulating before resorting to deference." At this point, deference is reduced to the status of a rare tiebreaker, draining *Auer* of its power.

Auer was no sport, for it was followed in 2015 in *Perez v. Mortgage Brokers*,[87] in which the Supreme Court held that the Secretary of Labor could define classes of exempt employees, and, more importantly, could reverse field without the benefit of a notice-and-comment proceeding. This variability on questions of law adds immense instability into the legal system, especially in a field as contentious as labor law, where administrative flip-flops between Democratic and Republican administrations are to be expected. The precise issue in *Mortgage Brokers* was whether under the FLSA mortgage-loan officers were exempt administrative employees. The history was erratic. The Department of Labor's Wage and Hours Division issued opinion letters holding that the employees were covered in 1999 and 2001, reversing this to exempt the same employees in 2006 and then restoring the previous status quo in 2010.[88]

Mortgage Bankers spent all of its time on the administrative law question and rejected the view that an extra-textual requirement could be added to the APA[89] without once asking how the job description squares with the statutory standard. But this is squarely at odds with the FLSA, which requires that the worker do (a) office or nonmanual work, (b) directly related to management or general business operations of the employer or the employer's customers, (c) a primary component of which involves the exercise of independent judgment and discretion about (d) matters of significance. The Wikipedia description of the mortgage loan officer tracks these four requirements to a T: "[T]hese officers recommend individual and business loans for approval and participate in the front end of the mortgage origination process. Although they are employed by financial institutions, they can be seen as intermediaries between lending institutions and borrowers. They solicit loans, represent

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[87] *Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199 (2015).
[88] Id at 1204–05.
[89] Id at 1206, citing *Vermont Yankee Nuclear Power Corp. v National Resources Defense Council, Inc*, 435 US 519 (1978).

creditors to borrowers, and represent borrowers to creditors."[90] Elsewhere Wikipedia adds "The process in the United States has become complex due to the proliferation of loan products and consumer protection regulations."[91] Why is this case difficult under any test of plain or ordinary meaning? But once deference is introduced the administrative fluidity necessarily engulfs all businesses that have to undertake mortgage loans, an effect which will radiate throughout the entire innovation space. A bad administrative law approach thus compounds the errors of an unwise substantive statute.

The second key conclusion of the once-proposed Overtime Final Rule is that it held that, for all non EAP workers, the exemption from the overtime regulation was raised from $23,660 per year, or $455 per week, to $47,892 per year, or $921 per week. For added measure it included an automatic increase in the exemption level every three years, so that it would keep up with inflation. The basic logic behind the Final Overtime Rule was to make sure that the coverage under the overtime regulation kept up with inflation, even if that meant doubling the basic figure. To achieve that result the study pegged the new figure to the "40th percentile of earnings of full-time salaried workers in the lowest wage Census region"—e.g. the South. The Report indicated that it "thought that the effects of this transformation would be small because by its calculation the $1.2 billion increased pay to employees and the $295 in average annual direct costs will together result in $1.5 billion dollars per year in increased costs for business—at most a tiny fraction of total U.S. payroll."[92]

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[90] *Loan Officer* (Wikipedia), archived at https://perma.cc/2HEP-QWS7.
[91] *Mortgage origination* (Wikipedia), archived at https://perma.cc/2BZN-BP9V.
[92] These quotations were drawn from *Overtime Final Rules Questions and Answer Page*, (Department of Labor), a resource which was previously available online https://www.dol.gov/whd/overtime/final2016/faq.htm but has since been removed from the DOL current website.

Not credible. That conclusion is at odds with the furious response to the rule in question from the effected state governments and private businesses covered by the FLSA, which notably does not apply to the federal government. The simplest explanation for the differential response comes in the use of the term "direct costs," a term that the Report conveniently leaves undefined. To see the large disconnect, note that this Final Report also estimates "that 4.2 million workers will be *directly affected* by the rule, and 8.9 million currently overtime- eligible workers will get *strengthened* overtime protections."[93]

Now, put the relevant numbers together and it appears that, for the 13.1 million workers involved, the anticipated cost is in the order of $110 per year, a figure that just has to be wrong once two other factors are taken into account: first, the large transition costs to understand how the rules will apply, and second, the added costs of compliance from putting this system into place, given the evident risk of penalties in a transitional period, which will require adjustments not only for covered workers, but for large number of workers whose responsibilities and compensation would have to be increased as part of some comprehensive revamp of the entire firm pay scale. It is clear that no one in business would treat the new challenges as the equivalent of an industry-wide tax increase of $1.5 billion which could be absorbed without undue difficulty. In addition, certain types of businesses would be hit much more heavily than others, including the three types of institutions that will be studied here: gig economy, start-ups and university research facilities.

The response to the new Obama DOL order was swift. Twenty-one states led by Nevada, joined by some 50 other business organizations, obtained a nationwide injunction against the Act in *State of Nevada v. United States Department of Labor*.[94] Judge Amos L.

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[93] Id.

[94] *Nevada v. United States DOL*, 218 F. Supp. 3d 520 (E.D. Tex. 2016). This opinion contains most of the salient background materials of relevance to the case.

Mazzant reviewed the three elements which had to be jointly satisfied for the EAP exemption to apply:

> First, the employee must be paid on a salary basis (the "salary-basis test"). Second, an employee must be paid at least the minimum salary level established by the regulations (the "salary-level test"). The current minimum salary level to qualify for the exemption is $455 per week ($23,660 annually) And third, an employee must perform executive, administrative, or professional duties (the "duties test").[95]

The first of these tests—salary basis—is routinely satisfied for the kinds of jobs that look like EAP positions. In any event, in a direct challenge to the rule, it is not necessary to identify which jobs are salaried, so long as it is known that some are. The second test—salary-level—is one that is set by the statute, so that much turns on the interaction between the salary-level test and the duty test. Judge Mazzant, an Obama appointee, held that the new regulation failed because it did not properly peg the EAP exemption to the employee's duties, but gave undue attention to the employee's salary and thus swept into the revised regulation EAPs who earned less than the $47,892 per year. He wrote "the Final Rule states that [w]hite collar employees subject to the salary level test earning less than $913 per week will not qualify for the EAP exemption, and therefore will be eligible for overtime, irrespective of their job duties and responsibilities."[96]

His position is in obvious tension with the rule that all three elements had to be satisfied, such that no worker under the new weekly amount could ever be exempt no matter what kind work he or she did. Judge Mazzant's decision could also be challenged on the ground that a simple shift in dollar minimum under the pay-level test, which left the definition of EAP unchanged, was within the broad discretion of the administrator under *Auer* and *Mortgage*

[95] Id at 524.
[96] Id at 530 (internal quotations omitted).

Brokers. In dealing with that question Judge Mazzant held that the prior lower standard was permissible because it weeded out only those individuals who were highly likely not to have EAP duties, while the newer class would contain many such individuals. It is an open question whether the DOL could have won an appeal on these grounds because the Trump administration did not pursue the case, in effect voiding the earlier Overtime Rule. The key question, however, is this: suppose that the dollar threshold had been raised so that a large chunk of the workforce was brought within its scope. How would that test apply? This issue is of key importance because there are multiple pressures to raise both minimum wage and overtime standards. The issue may be dormant but it is surely not dead. Hence it is appropriate to give a closer look at each of the three areas of the innovation economy detailed at the outset of this paper.

1. *The Riding Economy*

The first battlefield over which the hour has come into play has been in connection with the gig economy, where there has been extensive litigation. There are of course many variations on how the applicable standards apply but for ease of exposition, I shall generally focus on Uber—pace Lyft and Via—which is the firm that has borne the brunt of the litigation under both the FLSA and the analogous state rules.

Given the normative nature of the inquiry, it is instructive to first ask whether Uber (or indeed any of its competitors) would ever adopt the FLSA hour with all its refinements as its standard of compensation as a business matter. The answer to that question, confirmed by consistent practice, is an adamant no. The one sentence explanation is that in that line of business time is a terrible proxy for productivity, even if that time could be measured, which it cannot. All this is not to say that time does not factor into the equation. Indeed, Uber, which uses surge pricing for its ride, has a complicated formula that combines actual mileage with time in order to figure out

a fare for the customer, of which the driver gets 75 percent.[97] There is no way that any regulator could stumble upon the precise formula used.

The complexity of the overall system is easy to state and hard to regulate. Uber runs tens of thousands of transactions per day, for which it needs full clarity for the system to work, especially since all the driver's work is done outside the purview of the firm. Since there is only limited oversight, the key feature of the system is that, as a first approximation, every driver has a take it or leave it option to do the work. That one fact means that at any given time a person who works under the Uber umbrella can be doing nearly anything, as the District Court in *Razak v. Uber Technologies* noted: "Plaintiffs, inter alia, accepted rides from private clients, slept, did personal errands, smoked cigarettes, took personal phone calls, rejected trips because they were tired, and conducted business for their independent transportation companies." [98] Without Uber's salary rule, at any moment in time there must be a fact-intensive question of whether the work done was for Uber, the driver or some combination of the two. No sane business would ever try to tie compensation to inputs in situations like this when the output measure is the rides done pursuant to deals with individual customers consummated on the Uber network, for which Uber relies on its own metrics of time and distance to determine fare. The system also builds into the payment formula various offsets to the amount owed to take into account, for example, insurance, finance charges or industry due picked up by Uber.[99]

At this particular point, it is critical to note that the proper mode of compensation is as important to the drivers as it is to Uber. An inefficient compensation formula reduces the number of transactions that can take place on the network. In a world without regulation, the contract in question would go into as much detail as necessary to

[97] Greg Bensinger, *Uber Drivers Take Riders the Long Way—at Uber's Expense*, Wall St J, (Aug 13, 2018), archived at https://perma.cc/J5XY-XL6G.
[98] *Razak v. Uber Techs., Inc.*, 2018 WL 1744467, *9 (ED Pa 2018).
[99] Id at *15 n 24.

explain the relationship. The deal would not concern itself with any categorical distinction between employees and independent contractors, because the principle of freedom of contract would allow the parties to put together whatever hybrid arrangement they thought efficient by modifying some standard agreement already used to take into account needed variations.

To be sure, there might be some limitations on freedom of contract, but these would, and should, only be put in place to protect third parties who might be injured in some accident with an Uber driver. Historically, there are cases in which the private characterization of someone as an employee or independent contractor was not held to bind third parties who were injured, say, in an automobile accident.[100] But these issues are of little moment here, as the simple device of having liability insurance on both parties to cover the loss which protects innocent parties could be imposed here, just as it is on ordinary taxi cabs. More critically, whatever solution works best to cope with the externality question has no application to key issues in these cases, namely, the rights and responsibilities between the two parties. And where there are standard contracts throughout a firm or an industry, none of the ordinary defenses like mistake or misrepresentation apply. There is too much repeat business, contract standardization, reputational capital, and public knowledge for contractual terms to be upset on those grounds.

But we do not live today in a world in which freedom of contract operates. So instead courts have to face a key definitional challenge under the FLSA or comparable state laws: is a particular worker an employee who receives these full protections, or an independent contractor who is out from under the law? As a matter of first principle, the following declaration now contained in virtually all

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[100] See, for example, *Sandford v Goodridge*, 12 N.W.2d 40 (Iowa 1944) (holding that a route driver for defendant newspaper was not an independent contractor because the company retained effective control over his conduct).

these contracts should be both necessary and sufficient to resolve this particular question. "Customer [defined by the agreement as "an independent company in the business of providing transportation services"] acknowledges and agrees that Uber is a technology services provider that does not provide transportation services, function as a transportation carrier, nor operate as a broker for the transportation of passengers."[101] The parties are their own best judge of the question, and what they want in case after case resolves the matter.

Yet that approach has to be rejected on statutory grounds once the FSLA and the parallel state laws rule out the principle of freedom of contract. At this point, the most that can be said about this description is that it is relevant but not dispositive. Indeed, even some presumption in favor of the contractual solution is suspect under the FLSA worldview that all employee contracts are subject to potential domination that permeates every nook and cranny of that relationship. From the outset it has been clearly understood that allowing for any waivers would make hash of the regulatory intention of the FLSA. Allowing for waivers "would nullify the purposes of the [FLSA] and thwart the legislative policies it was designed to effectuate."[102] But once the clear rule is rejected, the only choice that is available is to resort to some list of factors, subject to the usual caveat that the exercise in all cases leads to this conclusion: "Applying these considerations requires weighing and balancing all of the circumstances. No one factor is dispositive and every factor need not point in the same direction for the court to conclude that the [unpaid] intern [in the movie business] is not an employee entitled to the minimum wage."[103] At this point, it follows that discovery—document requests, interrogatories, depositions—will always be a sprawling affair. Given the pliable structure of the law, courts have proved very reluctant to announce any general rules, when in the

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[101] *Razak*, 2018 WL 1744467 at *14 (ED Pa 2018).
[102] *Barrentine v Arkansas-Best Freight System, Inc*, 450 U.S. 728, 740 (1981).
[103] *Glatt v. Fox Searchlight Pictures, Inc*, 811 F.3d 528, 537 (2d Cir. 2015). See notes 137-40 and accompanying text.

next case some key factor will differ from what it was in the prior case.

The statement solemnly made above about interns in the movie industry carries over to the instant context, because it precludes any straight-forward efficiency analysis which would lead to the inescapable conclusion that the pricing universally endorsed by private firms is vastly superior to any administrative mandate under the FLSA. Yet the many cases about the classification problem rarely if ever ask the two questions that are most relevant to the matter. Was the deal efficient? Did it create the right incentives for both parties?

To see how this logic plays out in the context of Uber, it is useful to start with *Razak*, which contained an exhaustive analysis of the issues without once stopping to ask "What about the compliance burdens of having administrators and courts make millions of ad hoc overtime decisions for thousands of workers?" Instead, consistent with his institutional role, the judge applied the standard legal test for what counts as an independent contractor to these contracts. More concretely, he looked to *Donovan v. DialAmerica Marketing, Inc*,[104] where the Third Circuit adopted the Ninth Circuit's six part test as follows:

> 1) the degree of the alleged employer's right to control the manner in which the work is to be performed;
>
> (2) the alleged employee's opportunity for profit or loss depending upon his managerial skill;
>
> 3) the alleged employee's investment in equipment or materials required for his task, or his employment of helpers;
>
> (4) whether the service rendered requires a special skill;
>
> (5) the degree of permanence of the working relationship; and

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[104] *Donovan v. DialAmerica Mktg., Inc.*, 757 F.2d 1376 (3d Cir. 1985).

(6) whether the service rendered is an integral part of the alleged employer's business.[105]

The first sign of trouble with tests of this sort is that the complexity of each individual contract could easily lead to non-uniform judicial results for three related reasons that plague all multi-factorial tests. First, small differences in factual patterns can tip the balance one way or the other. As a company like Uber operates across state lines and in all sorts of urban, suburban and rural areas, local variations in practice may well turn out to matter. Second, different courts give different weights to the different factors. Third, different courts can disagree on the way in which any particular factor cuts. Hence, the entire process invites a fact-intensive inquiry of limited generalization—except of course for courts willing to adopt some per se rule.

With that said, it is important to note that the six factors mentioned above tend to divide three to three.

The obvious difficulty is that there are few pure types in any business, so Judge Baylson admirably tried to cut through the thicket in coming up with the right answer: independent status, even against the backdrop of a legislative history that tilts toward a broad definition of an employee. Thus, the key factor in all these cases turns on the driver's right to refuse work. But serious complications arise, because it is highly unlikely that any single factor will rate as either a 0 or 1. As a matter of business economics, the choice of contractual form requires trade-offs at the margin. Wholly apart from regulation, any firm will start with a presumption that cuts one way and then move away from the polar as circumstances require. So long as they know what the situation is, the contractual arrangements displace the presumptive characterization.

More specifically, the first factor, control, exhibits just these divided tendencies. It is a huge draw to let workers decide when to work and which rides to accept. But affording workers too much discretion could have a negative system-wide effect by slowing

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[105] Id at 1382, citing *Donovan v Sureway Cleaners*, 656 F2d 1368 (9th Cir 1981).

down the rate at which matches take place, to the detriment of all drivers. So three limits are placed on that decision. First, the driver has at most 15 seconds to accept or decline a ride. Inaction means that the offer is rejected. The alternative default rule would be an open invitation to disaster. Second, rejections are limited to three trip requests in a row. Too many negatives slow down the process, so the options are limited. Third, and most controversial, at least in Philadelphia, the driver has no knowledge of whether the trip is "short or very long." That last term strikes me as deeply problematic, if a customer wants to go 100 miles out of town. So it may well be that those rides are processed differently, even if short trips are done that way. There is a risk that drivers will start to favor certain neighborhoods. And last, unique to Philadelphia, is that trips from the airport or the main (30th Street) train station are assigned by queueing, where the only drivers eligible have entered in the lots. Anything else could lead to a mad dash. The net effect is that the ability to accept rides becomes a split variable, but on balance the ability to get out of the queue altogether by turning off the app is probably the most important feature, so factor number one cuts in favor of independent contractor status, as does the ability to work for multiple companies at the same time.

There is also a second dimension over which centralized control is needed. An insistent quality-control issue also influences the structure of all franchise arrangements, under which a large number of independent contractors sell similar products. The simple illustration is McDonalds, where the franchise contracts exhibit a complex scheme of divided control. The business decisions on whom to hire and fire are left to the franchise, who is only incentivized by a powerful profit and loss position. But that franchisee benefits inordinately from system-wide quality control to combat what would otherwise be a powerful prison's dilemma game, in which each individual franchisee would garner all the savings from compromising quality but suffer only a tiny portion of the brand deterioration that flows from being part of a less constant and reliable McDonald's network. Hence the company imposes real control over ingredients, modes of preparation, décor and signage—those golden arches. And it runs inspections to make sure that these rules are followed to the letter.

Uber has no golden arches. Indeed, its contracts typically provide that the drivers in its network (sometimes dangerously shortened to "its drivers"[106]) do not brand their cars at all. And for good reason. McDonalds depends on walk-in and drive through traffic. Uber depends on an app. Putting the Uber brand on a car does little to sell the product, but may attract others to damage the vehicle—which is one reason why rental car agencies do not brand their automobiles, knowing that thieves often think that there is valuable luggage locked in the trunk of a rental car. But the other elements do matter: the cleanliness of the car, the behavior of the driver, the performance on the trip. Hence the system provides for two-way evaluations—drivers of passengers and passengers of drivers—as a form of quality control that disciplines drivers and passengers alike.

Yet there is a chink within the system. In order to track riders, Uber has to offer a fixed price contract, and thus bear the uncertainty that the trip will turn out to be either easier or more difficult. It also pays its drivers on a formula that reflects accurate conditions, on the ground that it is the better bearer of risk. But that system has led to abuse because drivers who get paid in part by time actually spent have an incentive to use "long-hauling" whereby they take a longer route in order to get a higher hourly pay.[107] This strategy has its risks because the extra time makes the ride less attractive to the passenger. And the driver risks a bad report if a local passenger picks up the diversion. So the strategy tends to be tried against out-of-towners who do not know the route. It makes perfectly good sense for Uber to develop metrics to counter this strategy. But it would be a serious misfortune if this extra unit of control could tip the balance on the control factor against the driver's independent contractor status. The

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[106] See, for example, Andrew J. Hawkins, *Uber Redesigned its Driver App with Input From Actual Drivers*, The Verge (Apr 10, 2018), archived at https://perma.cc/HU6K-4SAE ("'I'm curious to see how the gamification of driving for Uber continues as I don't think Uber and its drivers always have interests that are aligned,' says Harry Campbell, a former Uber driver who runs The Rideshare Guy website.").

[107] See Bensinger, *Uber Drivers Take Riders the Long Way* (cited in note 98).

better approach is to note that these forms of control are justified as means to protect all drivers and all passengers from various forms of driver misconduct. These oversight provisions help all parties and hence should fall out of the discussion over employee versus independent contractor—at least for those courts that see how the game has played out.

A similar analysis applies to other features. Normally drivers use their own cars and thus make a fixed investment. But some Uber drivers use rental cars to avoid those fixed costs. Should that alter status? Does it matter how often this is done? Are special skills needed? Not to drive a car, but perhaps to deal with the business of driving passengers, which might require in some cases special licenses or permits, which could vary by locale? And what is meant by permanent status? No one treats driving for Uber as a lifetime commitment. Drivers may come in all sorts of patterns. Does long but part time service cash out different from shorter bursts of more intensive work? No one is quite sure. And what does it mean to be integrated into the business? These drivers are essential as a group for the business to survive. But no individual driver is that necessary and none of the drivers are involved in structuring the business or running any of the main facilities. So which is it?

It is instructive to note that the most notable case for finding employee status, *Berwick v. Uber Technologies*, gave different weights to these factors. Thus it followed the 1989 California decision in *S.G. Borello & Sons v. Department of Industrial Relations*[108] which took a short passage to upend the whole analysis given above. "The minimal degree of control that the employer created over the details of the work was not considered dispositive because the work did not require a high degree of skill and was an integral part of the employer's business. The employer was thus determined to be exercising all necessary control over the operation as a whole."[109]

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[108] *S. G. Borello & Sons, Inc. v. Dep't of Indus. Relations*, 48 Cal. 3d 341 (1989).
[109] Id at 355–60.

Factors 1, 4 and 6 are thus flipped over under a factual pattern that scarcely differed from that found in other cases.

Yet this approach is losing ground, for Judge Baylson relied on *Saleem v. Corp. Transportation Grp., Ltd*. [CTG][110] in which Judge Debra Livingston of the Second Circuit, writing for a unanimous panel, held that the defendant's drivers did not count as "employees:"

> [T]he record here does not permit the conclusion that Plaintiffs were employees, but instead establishes that they were in business for themselves [because] Plaintiffs independently determined (1) the manner and extent of their affiliation with CTG; (2) whether to work exclusively for CTG accounts or provide rides for CTG's rivals' clients and/or develop business of their own; (3) the degree to which they would invest in their driving businesses; and (4) when, where, and how regularly to provide rides for CTG clients.[111]

But once again, no hard rule. "In a different case, and with a different record, an entity that exercised similar control over clients, fees, and rules enforcement in ways analogous to the Defendants here" might be an "employer within the meaning of the FLSA."[112] The most we get out of any of these lengthy decisions is a presumption that will strengthen somewhat with repetition. But the case for the contractual solution is that it displaces endless anxiety and equivocation with a simple rule that gives the right answer all the time. What possible benefits offset the many millions in compliance costs that FLSA or analogous state regulation supply?

I see none, but defenders of the current regime are nothing if they are not persistent on the legislative front. Thus there are also more ambitious programs that try to respect the unique position of these

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[110] *Saleem v. Corp. Transp. Grp., Ltd.*, 854 F.3d 131 (2nd Cir 2017).
[111] Id at 149.
[112] Id.

drivers by putting rules into place to deal with their unique status. Thus James Surowiecki of the New Yorker lamented:

> The real problem here is that Uber drivers don't quite fit into either of the traditional categories. Declaring them independent contractors or employees, as a California judge presiding over a lawsuit against Lyft commented, means forcing a square peg into one of two round holes. We'd do better to create a third legal category of workers, who would be subject to certain regulations, and whose employers would be responsible for some costs (like, say, reimbursement of expenses and workers' compensation) but not others (like Social Security and Medicare taxes). [113]

Too clever by half. Sometimes moderation is the riskiest of strategies. The proposal does not take into account workers who work for more than one company, and it does not say which regulations apply and does not explain why workers' compensation is a better alternative than first party insurance. And there is of course no awareness of whether the numbers could ever work out. But, undeterred, Surowiecki plows into more dangerous territory and suggests that the real solution lies in comprehensive social programs to create a comprehensive social net complete with health care, workers' compensation and unemployment insurance.[114] From the frying pan into the fire.

For any of this to make sense, it would be necessary to show that the drivers who flock to Uber and similar companies are worse off than, say, their nearest competitors, who drive cabs. But there is evidence that many taxi drivers have switched to Uber and thus have

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[113] James Surowiecki, *Gigs with Benefits*, New Yorker (July 6 & 13, 2015), archived at https://perma.cc/9FTV-9VT9.
[114] Id.

voted with their feet.[115] And the reason is often that the hours are shorter and the benefits are higher. As Liya Palagashvili and Nawaphon Sittisawassakul have written: "And these Uber drivers are getting paid better, too. A study of Los Angeles cab drivers found that, on average, they worked on [sic] 72 hours a week for a wage of $8.39 an hour. Uber drivers, on average, worked less than 35 hours a week for $19 an hour."[116]

Undeterred, however, the New York City Council has recently accepted a recommendation of its Taxi and Limousine Commission (TLC) to impose a $17.22 minimum wage for ride-hailing firms like Uber.[117] Predictably, at no point does that report offer a systematic response to the monitoring and compliance problems raised earlier. The questions are by now familiar. How does this work, when it is impossible to monitor time? When drivers work for two or more services, as well as doing independent jobs of their own? When does down time begin and end and why? All companies switched to a per ride system because it offered a cheaper and more reliable metric than an hourly wage. No one has ever figured out how to convert piece rate work to hourly wage even in the simplest factory settings. Nonetheless, the official report devotes just one paragraph this critical issue.

> The driver payment standard is based on distance and time per trip as well as the company-specific utilization rate for the prior quarter. The utilization factor would serve as a basis for computing total driver working time (see the discussion in Section 2). The TLC should also access and

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[115] Andrew Tangel, *Trading Taxis for Uber, Drivers Riding a Boom*, Wall St J (July 31, 2015), archived at https://perma.cc/6MBZ-L7JH.
[116] Liya Palagashvili & Nawaphon Sittisawassakul, *Uber Under Attack: What Critics Get Wrong,* Fiscal Times (Nov 15, 2015), archived at https://perma.cc/X4FG-74HG, citing Gary Blasi and Jacqueline Leavitt, *Driving Poor: Tax Drivers and the Regulation of the Taxi Industry in Los Angeles*, archived at https://perma.cc/C7DB-XHWE.
[117] James A. Parrott and Michael Reich, *An Earnings Standard for New York City's App-based Drivers: Economic Analysis and Policy Assessment* (Center for New York City Affairs July 2018), archived at https://perma.cc/5MDS-TRMJ.

> analyze the app-on and app-off data for each driver to more effectively determine how trip pay translates into average hourly earnings for each driver. The TLC will have to determine the best way to account for multi-platform drivers—those who drive for more than one app company and who may be logged into more than one app at a time.

Note that everything quoted above is for "each driver." But it never backs this inquiry into the standard FLSA framework. No discussion of total driver time can rely solely on the time between pick-up and delivery. Just think of the waiting time complications set out above,[118] which are worth repeating here:

> **Waiting Time:** Whether waiting time is hours worked under the Act depends upon the particular circumstances. Generally, the facts may show that the employee was engaged to wait (which is work time) or the facts may show that the employee was waiting to be engaged (which is not work time). For example, a secretary who reads a book while waiting for dictation or a fireman who plays checkers while waiting for an alarm is working during such periods of inactivity. These employees have been "engaged to wait."

It is not credible to think that anyone can apply this treacherous distinction on a case-by-case basis to thousands of drivers engaged in tens of thousands of daily transactions. The only possible chance of making this scheme work for people who work for a single company is to work exclusively off the time reported for each, which or course gives drivers a perverse incentive to slow down their trips. The interstitial times cannot be measured. The calculations are only more speculative when there are multiple firms involved. But on that issue the Commission just punts, leaving the hard question of implementation for another day. In so doing it reverses the sequence. First it passes the law, and then it tries to figure out what it all means.

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[118] See notes 48–65 and accompanying text.

But none of these issues are addressed in the legislation, which leaves unallocated the huge administrative burden of putting this unwanted scheme into play. The difficulty of converting piece rate into hourly wage is a thousand times more difficult in this context than it is on the factory floor. Yet there is no sunset provision on the minimum wage component of the New York City ordinance.

To be sure, the regulations have now been put into place, with the promise of raises of about $10,000 per driver of Uber, Lyft and other similar companies.[119] The consequences are not unexpected: the cost per ride has gone up,[120]and Uber and Lyft have stopped hiring new drivers in New York City.[121] The context of the new minimum wage laws may be novel, but the consequences are all too predictable, as firms and customers respond to the incentives created by the regulations.

Nor should anyone take comfort that the one-year moratorium on new Uber, Lyft and rival services lasts only for one year. Nothing in the ordinance prevents its extension year by year, so that the temporary regime by degrees becomes de facto permanent. By making these changes year by year, New York City helps insulate itself from a possible constitutional challenge given that current law unwisely makes it more difficult to challenge temporary takings than permanent ones. It is no accident that both New York City and State take painful care to renew their rent control ordinances on a three-year cycle—as they have done for at least the last 50 years.[122] But

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[119] Adam Smith, *New York City Imposes Minimum Pay Regulations for Uber and Lyft*, TheStreet (December 5, 2018), archived at https://perma.cc/FQW2-E8U6.
[120] Andrew J. Hawkins, *NYC's new driver wage law means the days of cheap Uber rides are over*, The Verge (February 1, 2019), archived at https://perma.cc/4EWW-CXU3.
[121] Andrew J. Hawkins, *Uber and Lyft stop hiring new drivers in New York City*, The Verge (April 29, 2019), archived at https://perma.cc/DSX8-3L9M.
[122] New York City Rent Stabilization Law, codified as amended at NYC Admin Code § 26-501 et seq. These laws have been repeatedly sustained. See, for example, *Rent Stabilization Association of New York City, Inc v Higgins*, 630 NE2d 626 (NY 1993); *Harmon v Markus*, 412 Fed Appx 420 (2d Cir 2011). The origin of the distinction between temporary and permanent rent control laws is found in *Block v Hirsh*, 256 US 135 (1921),

whether it is done for one year or many, its most probable effect is to cartelize the entire industry—traditional cabs, app-cabs, and traditional limo service—which will constrain supply and thus raise prices. Indeed, one unaddressed issue in this case is which drivers are allowed to enter the market when current drivers decide to leave it. It is hard to assign that right to individual companies, especially when drivers work for multiple firms, but it is also difficult to identify any simple and sensible system of replacement that could be run by New York City itself. Yet unless that problem is solved, the shortages of these services will only become more severe.

Yet, at the same time, it is doubtful that this ordinance can make a dent in the congestion problem. Again, as Liya Palagashvili explains, there are too many other causes that explain the problem, and too many better alternatives for dealing with it.[123] The first point is that traffic congestion is not only a function of the number of cars and vehicles on the road, which increased by between 18 and 24 percent between 2009 and 2015 even before the rise of Uber-like services in the last three years, which is at best a two edged sword, for the large supply is in response to a large demand. Similarly, the increase in freight movement, tourism, and construction has its impact on streets. Ironically, in this situation, ride-calling services could easily be a boon because they encourage people to leave their own cars outside the city, where they take up far less space. Indeed, given the adaption by other drivers, one possible effect of the new ordinance is an increase in privately owned cars on New York City streets, which will offset any cap imposed on Uber and its competitors. It could therefore be that the level of traffic on the roads will not decrease, but that the carrying capacity of the system will decrease as more efficient for-hire vehicles are driven off the roads. Why should New York City impose a ban on new ride-sharing and

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in which Justice Holmes upheld the law on the grounds that it responded to a short term emergency, as defined by the legislature. The public emergency is a pious fiction in modern law.

[123] Liya Palagashvili, *Actually, Curbing Uber Won't Relieve Heavy Traffic*, NY Times (Aug 2, 2018), archived at https://perma.cc/5XLX-5R9U.

hailing-services when these may have far greater value than, say, the use of preexisting private cars?

The hard question here is that there is no public metric to decide administratively which vehicles should remain on the roads and which not. The only sensible way to attack the congestion problem is directly, by using a system of peak-load pricing familiar to electrical utilities to get people to cut down on demand when the social dislocations are the greatest. The artificial cap is a competing attempt to achieve the same end by allocating frequency spectrum by administrative hearing, when by far the better approach is a bid system under which the parties with the greatest anticipated value will gain access to a scarce good. As with so much of more technology, the trick is not to invent novel solutions to solve what turn out to be familiar problems. It is to use the traditional mechanisms more correctly.

2. *FLSA and Start-Ups*

One of the most problematic areas involving the application of the FLSA and similar state laws, most notably those of California, are the rules governing the workers in tech start-ups. As in earlier cases, the key question is the extent to which the requirements of these laws require alteration of the terms of compensation from those that firms would pay and workers would receive in an unregulated market. The issues here are more idiosyncratic than systematic, for by definition start-ups have no market power, and so there is no single Uber to consider as a case study which does. Start-ups are also notoriously quirky. They usually, often self-consciously, follow different strategies that reflect the personalities of their founders, hire different types of employees, make different kinds of deals, and reconstitute themselves periodically on the road to success or ruination. As a political and legal matter, it is difficult to launch the same kind of concentrated assault against these small firms that can be mounted against a dominant firm like Uber. The case law therefore is relatively undeveloped, and much therefore depends on working the way through the various statutory and regulatory requirements.

Yet before undertaking that task, the question remains, why impose these minimum hour and overtime requirements in the first place? In this case, it is useful to note that a start-up employee's current income is no reflection of their earnings potential down the road. These tech workers often stand at the top of the labor market. Education renders them upwardly mobile, and one of the key elements that they hope to obtain from their job is from the further investment in their human capital—gains that are nowhere captured in the wage and overtime formulas of the FLSA.[124] They take lower wages and salaries today to build up their long term portfolios, and borrow to even out their consumption over their professional lifetimes. They bear no resemblance what the Supreme Court has called the "unprotected, unorganized and lowest paid of the nation's working population." [125] They have strong educations and mathematical skills and are more concerned with an equity position than a "minimum subsistence wage."[126] Their services, desirable for start-ups, are also valuable in working for large established firms. Many are young and inexperienced. But they are quick learners and surprisingly tech savvy about their own contracts. They can, and do, switch jobs, often annually; they play off one employer against another. There is no reason to think that they cannot hold their own with employers, both large and small, in an unregulated market, and good reason to believe that they are as much hurt as employers by the restrictions of the FLSA and its state analogues. Some of these workers may fit into the class of EAP employees, at least if it is not narrowed by administrative decisions of the sort found in *Auer*. But surely some will remain non-exempt workers subject to the act. Any effort to restrict the contractual freedom of employers imposes like restrictions on the contractual freedom of employees. In order to justify the restriction, it would be useful to point out one of two weaknesses in this market. The first is some negative externality

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[124] For a general discussion, see Gary S. Becker, *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education* (Chicago 3d ed 1993).
[125] *Brooklyn Savings Bank v O'Neil*, 324 U.S. 697, 707 n18 (1945).
[126] Id.

generated by these contractual arguments, of which there seem to be none. Second, someone might posit a systematic break-down in the contractual process that calls for this form of intervention that some lesser form of intervention—full disclosure in writing on contractual terms—is unable to oppose. But again there seems to be no systematic break-down in contract formation to justify this massive interference, which looks more and more like a relic of an earlier generation. Certainly, if, as I believe, the FLSA is regarded as a mistake in ordinary labor markets, it has to count as a bigger mistake in this modern tech area. Conversely, even if the FLSA were justified for low-educated manual or factory workers, it hardly follows that it has a useful role to play in this modern context.

Needed or not, however, the FLSA is here to stay, and so the question is how to make the system work in a world where the in-kind compensation is not a cot to sleep on, but a set of stock options and share purchases that are not asset classes used by manual laborers and office workers. Yet, it is just the dominant role of noncash stock options and shares that are common in start-ups. In any new enterprise, the conservation of cash is a key requirement of the firm, which typically prefers to pay at least some portion of its compensation in stock or stock options. The workers in turn like these deals as well. The economic logic explains why both sides sign on. Start-ups have huge risks, and deferred compensation in options and shares is a sensible risk-sharing device that lowers the "burn rate" of cash for the start-up, while giving key employees the chance to strike it rich if the business should take off. If the cash compensation salary-level is high, the extra compensation is neither here nor there, because the workers are out from under the FLSA. But if the stated salary is below the exemption threshold, much can turn on when and how this compensation is supplied.

It is for this reason that the battle over the salary-level that was fought and lost by the Obama administration matters so much in so many jurisdictions, because the cash compensation level for entry-level employees in start-ups may well fall between $23,660 per year (or $455 per week) and $47,892 per year (or $921 per week) to which the Obama administration proposed moving the salary-floor in 2016. Removing these workers from the jaws of the FLSA offers an enormous simplification of the law—at least if state law minimums

are not higher, which they are for example in California (whose minimum wage law is now higher than the federal level, with certain cities (e.g. Palo Alto) having still higher minimums).

In many cases, however, the question of the role of equity compensation will be central to a finding of noncompliance with the FLSA or state laws. On the one hand, in some cases, an employer would wish to keep that form of compensation outside the wage base in order to minimize the overtime exposure for certain covered workers. If the compensation with equity benefits is below the general salary-threshold, so that the overtime laws apply, putting those benefits in the base increases an employer's exposure to liability for overtime pay. But if the salary is below the minimum wage level, then adding in some equity into the wage equation could well prevent a violation of the minimum wage laws.

The Worker Economic Opportunity Act of 2000[127] reveals some of the technical difficulties in dealing with this issue.[128] The new statutory provisions address the possibility that various options and shares will be brought back into the overtime base of non-EAP workers upon their exercise, such that the employer is then required to recalculate upward the amount of money owed for the two years prior to the date on which the options were exercised. Among the conditions that the employer must satisfy to keep the exercise value of these options and shares out of the base are as follows: (1) Its terms must be clearly communicated to the worker, (2) the exercise of the option or share purchase must be "voluntary," (3) the first payment must under the plan not vest within six months of the option, and (4) the exercise price of the option must equal at least 85% of the fair

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[127] Pub L No 106-202. 114 Stat 308 (2000), codified at 29 USC § 201 et seq (amending the FLSA).

[128] *Wage and Hour Division Fact Sheet #56: Stock Options under the Fair Labor Standards Act (FLSA)* (U.S. Department of Labor, July 2008), archived at https://perma.cc/LAY9-5DJR. For discussion, see Cooley LLP, *Cooley Alert: Fair Labor Standards Act Amended to Exclude Some But Not All Stock Option Compensation from Overtime Calculations* (FindLaw), archived at https://perma.cc/WK9Y-4J5N.

market value of the stock at the time of the grant—no easy calculation for shares that are not publicly traded. There are further tests for deciding whether performance-based options are covered—although nonperformance based options can be issued. The failure to meet these conditions could result in the inclusion of the exercised value in the base for overtime pay.

It is beyond the scope of this article to delve into these various intricacies, but it is important to ask why this kind of provision is needed at all in this industry sector. The explanation for these collateral provisions is not that they are desired in themselves. It is that they must be put into place to backstop the basic minimum wage and overtime provisions, which would otherwise be gutted if in-kind compensation allowed employers to evade the basic overtime provision. But at this point, the internal integrity of the system has become an end in itself wholly divorced from any independent justification for the provisions in question. The entire apparatus disappears if some carve out for all start-up activities is put into the FLSA. To be sure, in at least some cases, various persons who work for the firm might fall into the EAP exception or count as independent contractors. But all-too often these are case-by-case "facts and circumstances" determinations. Just when a tech worker becomes a professional (in a field in which degrees are weak indicators of ability) is left unclear. And it is in general difficult for workers who put in long hours in start-ups to earn independent contractor status, given that they are heavily integrated into the business operations. These firms bear no resemblance to the hub and spoke operations of the type used by Uber, where the independent contractor status has gained ground. There is a poor fit between the FLSA and modern operations. Tinkering can make the system marginally better. But total repeal could produce both large allocative gains and large savings in administrative costs.

3. Research Universities

The last of the recent applications of the FLSA is to the research activities that take place in large private and public universities throughout the United States. Wholly apart from the question of which full-time employers are entitled to EAP status, there is a

second question of immense importance. Does the FLSA cover those persons who are pursuing degrees, or even those under post-doctorate fellowships? In these cases, the classification question left open by the statutory definition does not concern the line between employee and independent contractor. Rather it concerns the different, but equally important line between student and employee. There are many cases within universities where individuals are treated as hourly employees if they are engaged in the kind of tasks that can be done by full-time workers: checking out books in the library, serving meals in the cafeteria, delivering documents on campus. But the student who works on his or her laboratory project cannot segregate his or her time between the student work for the degree and the assistance provided to faculty supervisors who publish their own projects. Often these two lines of work overlap so much that even the parties themselves cannot keep them apart, especially if an hourly accounting is required, which is why the university and federal grants stipulate an annual salary for research affiliates without regard to the particular tasks referred to at any given time.

This question of status is also of importance in dealing with rights of collective bargaining, which are conferred on employees but not upon students. Suffice it to say that the question is one on which administrators have gone both ways. Most recently, in August, 2016, the National Labor Relations Board in *Trustees of Columbia University and Graduate Workers of Columbia-GWC, UAW*[129] found that these graduate students could unionize because they were, at least in part, employees of the University. *Columbia* overruled an earlier decision in *Brown University*[130] that had resolved that question in favor of

[129] *The Trustees of Columbia University in the City of New York and Graduate Workers of Columbia–GWC, UAW*, 364 NLRB 90 (Aug 23, 2016).

[130] *Brown University* and *International Union, United Automobile, Aerospace and Agricultural Implement Workers of America, UAW AFL–CIO*, 342 NLRB 42 (July 13, 2004).

student status by overruling an earlier 2000 decision involving *New York University*.[131] Note the double flip-flop in a sixteen-year period.

The issue is of more than passing interest to the FLSA situation because the critical statutory definition of an employee under the National Labor Relations Act bears a close resemblance to the language used in the FLSA some three years later: Section 2(3), which provides in relevant part that "[t]he term 'employee' shall include any employee," gives no guidance at all on the question of dual status persons. As a statutory matter, the issue was treated as turning on a presumption in favor of collective bargaining for "workers", thereby begging the question of the status of these graduate students researchers. It then further held, without differentiation, that the same principles should apply to research assistants as well as to other graduate students, including those who teach small sections of basic freshman and sophomore courses.

The question then arises whether the same conclusion applies to employees under the FLSA, where the Board majority noted that the FLSA definition is somewhat different because it is not as tightly tethered to the common law definition of employment which it gleans from the statutory material.[132] But the point is somewhat disingenuous. The Board majority dutifully noted without citation that the traditional test used under the FLSA was whether the worker in question was the "primary beneficiary" for the arrangement or not.[133] Indeed, that test was incorporated early into the FLSA by the Supreme Court in yet another of its guarded pronouncements in *Armour & Co. v. Wantock*: "Whether time is spent predominantly for the employer's benefit or for the employee's is a question dependent

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[131] *New York University* and *International Union, United Automobile, Aerospace and Agricultural Implement Workers of America, AFL–CIO*, 332 NLRB 1205 (Oct 31, 2000).
[132] *Columbia*, 364 NLRB at *5 n 49.
[133] Id. ("Because the FLSA definition of a statutory employee is not tethered to the common law (as the Act's definition is), and because the FLSA reflects policy goals distinct from those of the Act, we are not persuaded that the 'primary beneficiary' analysis should govern this case.").

upon all the circumstances of the case."[134] *Armour* was a companion case to *Skidmore* that dealt with the treatment of waiting time for workers who were awake but on call. And it stands for the proposition that "inactive duty" may nonetheless be duty. It is then carried over to this very different context where highly active workers are engaged in two kinds of task simultaneously. The more recent case law on this issue did not concern factory workers or graduate students, but rather workers in a variety of internship or training programs associated with their efforts to make their way into their chosen occupation. The earliest of these cases, *Walling v. Portland Terminal Co.*[135] involved brakeman-trainees taking a short course in order to prepare themselves to become paid apprentices within the union structure. The stated reasons for allowing these workers to escape the employee designation that would subject them to minimum wage protection was that the work did not displace regular employees, and did not expedite the employer's business.[136] Instead the course allowed these workers to achieve some educational advantage which would enable them to find a future job within their chosen field.

In later cases, the trainees are often current or recently graduated students who have taken unpaid positions in, say, the film industry, and have for their assigned duties such menial tasks as rearranging furniture, taking out the trash, or getting drinks and picking up food for the paid staff, photocopying, or showing people around the premises.[137] In dealing with this issue, the government in *Glatt* sought to give exclusive weight to the six factors that it claimed achieved the balance set out below.[138] On that issue, the government

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[134] *Armour & Co. v. Wantock*, 323 U.S. 126, 133 (1944).
[135] *Walling v. Portland Terminal Co.*, 330 U.S. 148 (1947).
[136] Id at 149–50.
[137] *Glatt v. Fox Searchlight Pictures, Inc.*, 811 F.3d 528, 532 (2d Cir. 2015).
[138] The relevant factors are, id at 534–35:

received a frosty reception as the Court refused to cabin itself to those factors, which had resulted in a summary judgment on the question of employee status in the district court. But the Second Circuit did not undo, as under the law it could not undo, the earlier judgment by taking the simple view that the parties determine their job status—employee or student intern—by agreement. Instead, by adopting the primary benefit test, it *expanded* the list of relevant factors, without, of course, giving a clear answer to the classification issue before it. Thus the Second Circuit said that it was remanding the case for further determination that looked at all the factors that might bear on the ultimate question, without, of course, expressing an opinion as to how the particular question should ultimately be resolved.

Similarly, in an earlier case, the defendant in *Schumann* did not get a summary judgment when the question was whether student registered nurse anesthetists ("SRNAs") enrolled in a master's

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1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training which would be given in an educational environment;

2. The internship experience is for the benefit of the intern;

3. The intern does not displace regular employees, but works under close supervision of existing staff;

4. The employer that provides the training derives no immediate advantage from the activities of the intern; and on occasion its operations may actually be impeded;

5. The intern is not necessarily entitled to a job at the conclusion of the internship; and

6. The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

program were employees when they participated in a clinical training program run by a physician affiliate (who held shares in the school) to get the necessary preparation to enter the profession.[139] Once again the agreement stated clearly that the student workers were not to be treated as employees under the FLSA, and once again the issues were sufficiently fraught with difficulties that the Eleventh Circuit first chastised the DOL, noting "with all due respect to the Department of Labor, it has no more expertise in construing a Supreme Court case [*Portland Terminal*] than does the Judiciary."[140] But just as the Second Circuit would later do in *Glatt*, the Eleventh Circuit remanded the case for further consideration after an exhaustive consideration of the relevant factors.

These and other sorry episodes reinforced the two lessons. The disingenuous nature of these decisions are clearly seen when measured against any theory of contractual formation that has as its key element the *mutual benefit* of both parties to the arrangement. These joint benefits must be ubiquitous in the film industry because of the large number of students and others who queue to obtain these positions full knowing that they will receive no pay for their work. Under the traditional analysis this counts as but one factor among many—which is why all these cases end up being matters of fact and circumstances. But as was the case with the Uber contracts, as a matter of first principle, the self-designation should be the one and only factor that matters, at which point all these cases result in summary judgment for the defendant—a conclusion barred by the nonwaiver rule of the FSLA.

At this point, the Second Circuit, like every other court that had viewed this issue, was sensitive to the substantial risk that the imposition of the minimum wage law to these students would spell the death-knell to the system from which everyone prospered. So it indulged in statements that simply make no sense. Employers have costs in having interns about the premises, which they would not be

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[139] *Schumann v. Collier Anesthesia, P.A.*, 803 F.3d 1199 (11th Cir. 2015).
[140] Id at 1203.

prepared to absorb unless the received some immediate benefit from the arrangement, which, the six-factors notwithstanding, they do. If they did not have these interns about they would have to do the work themselves, which is costly for high-priced talent, or hire unskilled labor to discharge that task, which they might not do as well as interns with their higher educational levels. So of course the interns displace these potential employees in the short run. But at the same time the higher level of productivity may well expand the business so that other unskilled workers could find work somewhere else in the production—a vital possibility that cannot be caught by any regulatory system because it requires the administrators to look too far afield.

At the same time, the deal has to have net benefit for the intern who has to perform menial tasks and forgo the possibility of earning some income at a minimum wage job elsewhere in the economy. And of course it does. The interns get to watch and to learn how the business of production is done, something which cannot be done in a classroom. They meet people in the industry. They can turn their contacts into recommendations for paying jobs elsewhere, and often even land a position at the firm in question. In line with the six factors, these jobs are never guaranteed because there is insufficient information at the outset of the relationship as to the fit between the two parties. But it is this full set of intangible benefits—including increments to human capital and access to job markets—that drives the relationship and makes, from the point of view of the intern, the cash component unimportant. Many interns would pay to have their positions, and call it, happily, tuition. Ironically, if there were no minimum wage law, the equilibrium might shift in favor of giving some small cash component to interns in order to expand the supply or improve morale. But, as with the case in *Skidmore*, no employer dares to supply those benefits in the current situation, for that would be an open admission that the FLSA does apply, at which point all the ruinous minimum wage and overtime limits would kick in, thereby destroying the deal. It follows therefore that the widely observed distinction between interns and employees has to have a harder edge than cases like *Glatt* provide.

Nor is the dynamic any different with the SRNAs in *Schuman*. They know that this work is necessary to gain licenses to practice,

and the instructional component is large enough that they would, if need be, take the work without pay. It is also the case again that the intermediate solution is foreclosed, for to pay the students anything is to concede their employee status. These cases, for all their muddiness, seem to tilt in favor of denying employee status, which is why the Board majority in *Columbia University* refused to engage with them. It is not because of some deep difference between the two statutes, both of which were born of the New Deal conviction that protection of workers from market forces was strictly needed—even if they did not, as in *Gonzalez*, ask the question of what should be done when unionized workers sought the protection of the NLRA. Its conclusion was here that as the university exerts "the requisite control over the research assistant's work, and specific work is performed as a condition of receiving the financial award, a research assistant is properly treated as an employee under the Act."[141]

But the point here is painfully clear. The graduate students do not perform the list of menial tasks that are performed by interns. And they are not working in for-profit firms as in *Schumann*. The level of benefits that they derive from these positions are at least as great as those which the interns receive from their unpaid jobs, and nurse practitioners receive from clinical training. To carry over the primary beneficiary test is to concede that the earlier rules that held that these people were primarily students could not be resisted, even under the NLRA. Indeed, is difficult to find any functional difference between these two decisions that explains why the coverage decision should come out different, and there is thus the real possibility that the Board decision, if not overturned first, could upset the established precedent under the FLSA, given that the Board majority does not identify why the FLSA "reflects policy goals distinct from those of the Act."[142]

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[141] *Columbia*, 364 NLRB at *17.
[142] Id at *5 n 49.

The implications of this decision for research activities are profound. There is little doubt that the faculty-student relationship is supposed to be collaborative while the employer-employee relationship is often adversarial. It is no small irony that elite (and liberal) universities filed a brief before the NLRB in which they insisted that the close interconnection between academic and instructional work made inapplicable the industrial union model on which the majority of the Board eventually relied.[143] The majority of the Board shrugged off these concerns.[144] But it remains, to say the least, an open question whether any collective bargaining agreement that seeks to deal with these business relationships can successfully cordon off the activities of the second, when the same faculty member—not versed in the fine points of labor relations—may be required to supervise both. To be sure, it may be possible to deal with these issues where graduate students teach small sections of undergraduates in first year or introductory courses, but the obligations of research assistants are far more fluid, and thus far harder to segregate into two separate bins.

It is possible, of course, for the negotiation process to exclude research assistants from the collective bargaining unit, and it may well be in the interest of the union to secure the support of the teaching assistants without having to negotiate on behalf of advanced Ph.D. students with quite distinct interests. And in fact just that outcome happened with the collective bargaining agreement that NYU negotiated with the union in advance of the Board decision that excluded from its collective bargaining agreement "research assistants at Polytechnic Institute, research assistants in the Biology,

[143] Brief of Amici Curiae, Brown University, Cornell University, Dartmouth College, Harvard University, Massachusetts Institute of Technology, University of Pennsylvania, Princeton University, Stanford University, Yale University, *Columbia* 364 NLRB 90, archived at https://perma.cc/35TT-HFBU.

[144] *Columbia*, 364 NLRB at *10 ("[T]here is no good reason to doubt that unions and universities will be able to negotiate contract language to delineate mutually satisfactory boundaries of their respective rights and obligations.").

Chemistry, Neural Science, Physics, Mathematics, Computer Science and Psychology departments, guards and supervisors as defined in the National Labor Relations Act."[145]

The situation under the FLSA is quite different because if the NLRA definition carries over—as it easily could—it applies to all employees whether or not they are represented by the union. At this point, it is quite possible that, in line with the California decision on the status of Uber drivers, the Department of Labor could find that the employer exercises "the requisite control" over these workers that they could be included, either in whole or in part, in the class of covered employees subject to the FLSA and New York State minimum wage and overtime regulations, at which point the compliance issues become frightening. It is also the case that many of these graduate students, including those who are paid for by government grants, have stipends over the current $23,660 per year level but below the proposed a $47,892 threshold. It seems quite clear that the combined costs of audit, compliance, and fines make it impossible to find a safe harbor for hiring these graduate assistants for anything below the stated salary level. Yet again the same question has to be asked. Are these the people for whom the FLSA protections make any sense? Ordinary industrial workers do not think of their current position as training for future jobs that carry wages far above the cap. Indeed, it is here that the same set of intangible benefits that attract interns in the movie industry apply to research assistants, who also have long-term career ambitions.

To be sure, one can forget the cash for these research assistants. But, without question, the bulk of the compensation for these workers is the enormous nontaxable increase in human capital that *in no way* figures into the wage calculations made by the FLSA. That total disjunction means that monetary compensation based on any

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[145] Collective Bargaining Agreement Between New York University and International Union, UAW, AFL-CIO and Local 2110, UAW, Article I, archived at https://perma.cc/VS6Q-52Z7.

hourly system is a useless proxy for the total compensation that these students receive. We know that number has to be quite high because of the willingness of students to take these positions even though their preexisting skills could command far higher wages in the labor market. But for these workers the permanent income hypothesis is in full force: they will borrow if need be today to make investments to advance their future job careers.[146] They will sacrifice current income for an increase in human capital that lies outside the ability of any regulator to measure—assuming that they even identify it in the first place. It becomes all too clear that current income is a poor proxy for permanent income, all of which is ignored under the FLSA, which only looks to current cash and other current receipts as a measure of economic wealth. One of the great achievements of the Trump administration is that, by doing nothing to defend the Obama administration's proposal for a cap increase, it has helped keep the innovation economy alive in multiple sectors. The same principles that explain why the FLSA is a legal dinosaur in other portions of the innovation economy thus carry over here.

CONCLUSION

The purpose of this article has been to offer a reasonably comprehensive account of how the law treats two interrelated conceptions—what is a compensable hour and who is an employee—in both market and regulatory contexts. This issue, though commonly neglected, casts a very long shadow over the history of constitutional law and the regulation of labor markets both at the state and the federal level. Both minimum wage and overtime regulation are ubiquitous. They are often challenged on pure economic grounds that assume away all the measurement and definitional issues that are raised in this paper which point to a set of technical problems of largely unappreciated significance.

The optimistic view of regulators past and present is that that they could capture enough information about the nature of the

[146] See Milton Friedman, *A Theory of the Consumption Function* 20–37 (Princeton 1957).

employment relationship to impose their minimum wage and overtime laws with a minimum of distortions, so that, in the words of the FLSA, Congress can just "declare" its policy to eliminate substandard conditions throughout industry "without substantially curtailing employment or earning power."[147] But this proposal is one of wishful thinking, as even under ideal circumstances wage and hours constraints exert a powerful influence. But given the imperfections of the system of measurement, the distortions in the operation of the system are far greater than those simple models proposed.

So let us put aside the common economic proposition that competitive markets generate optimal contracts in employment markets as they do everywhere else. Once a system of regulation was put into place, regulators quickly understood that they had to keep pace with the adaptive responses that many employers would make (often with the support of their workers) to undermine the enforcement of the Act. Hence the regulatory pyramid developed a broader base and a higher top as administrators grappled with such issues as who counts as an employee and how their compensation should be measured, all the while consistently ignoring the immense variation that goes into the operation of a single hour. On these issues of implementation, the FLSA is largely silent, and so are many of the state imitators which think that the problem can be solved by delegation to administrative agencies. In responding to these challenges, there is as always a wide variation in the caliber and neutrality of the judges and administrators who are charged with the interpretation and enforcement of the act. There are many conscientious parties who struggle to find the middle ground in interpreting these various statutory commands, and they quickly find that the torrent of relevant factors resists classification as simple rules. Facts and circumstances dominate everywhere, and exhaustive inquiries are often required in literally hundreds and thousands of cases. But just as many judges and administrators struggle to find the

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[147] See FLSA Section 202(b) (cited in note 2).

right answers, others become so wedded to the notion of worker protection that a relentless expansion of coverage and protection becomes an article of faith. Those charges can be properly lodged against the Department of Labor in the Obama Administration, the California courts legislature in connection with the *Gonzalez*, and the de Blasio administration in New York City in its regulation of Uber and its competitors. For these parties, aggressive enforcement of wage and hour laws becomes an article of political faith, regardless of the practical consequences.

These misguided initiatives do nothing to help with the processes of innovation today on which the economic growth of tomorrow depends. Indeed, there is no area in which the FLSA and its state analogues do any good, and many in which it has the potential to create massive distortions. The variability of the hour has been a constant problem since the early Courts tried to deal with sleeping on the job in cases like *Lochner* and *Skidmore*. The inability to translate piecework into hours, or to figure out how to impose overtime restrictions on salaries or commissioned workers, is far more difficult than any legislature or court imagined, whether calculated by day, week or month, especially for people who by choice have multiple income sources. The distortions imposed by the statute are always positive, but they are not of equal magnitude. The hour is a perfectly serviceable standard for compensation when both parties want to rely on it contractually, even if the regulation of wages and hours remains a serious economic mistake. But by the same token, the situation gets far worse when both parties rely on a different ruler to determine compensation, which happens whenever compensation is done on a piece rate basis, or fixed wages are only part of the overall compensation package that involves all sorts of in-kind benefits on the job, or with creation of future job opportunities and increases in human capital, which regulators have to ignore because they cannot measure intangible benefits whose worth is all too apparent to their recipients. Even before the American economy diversified away from the large assembly lines of the 1930s and 1940s, the hour was at best an erratic measure of compensation, as *Lochner* and *Skidmore* show. Indeed, the more idiosyncratic the employment relationship, the greater the distortions from the one-size-fits all regimes of federal and state law. And so, as workplaces become ever

more diverse today, the older systems of regulation become ever more costly to maintain.

So what is to be done? It may well be impossible politically to undo a statute that has never made any sense, but imposes larger costs over time. But it should be possible to minimize its damage by reducing the scope of its coverage, so that it is easier for employers and employees to escape its impact in any number of ways. These parties should be encouraged to take advantage of more frequent exemptions, as with EAP workers, and they stand to benefit from a broader definition of an independent contractor on the one side or graduate student on the other. And legislators can keep both minimum wage and salary-level thresholds as low as possible, so as to reduce the drag on the economy. Ultimately, the political and administrative resolution of modern disputes will largely turn on whether the decision-makers accept the naïve notion that these statutes "protect" workers even as they limit their options. The difference between a narrow interpretation and a total repeal of wage and hour laws may, oddly enough, turn out to be of vast importance in an age when legislative repeal or constitutional invalidation is no longer on the table. Debates over first principles therefore always lurk in the background. And on this issue the takeaway message should close the circle. A provision that never made any sense should never be broadly construed.