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DOL's New Independent Contractor Rule: A Return to 2020

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It's been a bumpy road for the federal rules on independent contractor status under the Fair Labor Standards Act.

In the courts, the test has always focused on the "economic reality" of the relationship between a worker and the entity that benefits from the services provided to determine whether the worker is an employee or an independent contractor. The primary factors considered, which derive from the Supreme Court's 1947 decision in *United States v. Silk*, are (1) the degree of control exercised by the employer over the worker, (2) the worker's opportunity for profit or loss and their investment in the business, (3) the degree of skill and independent initiative required to perform the work, (4) the permanence or duration of the working relationship, and (5) the extent to which the work is an integral part of the employer's business. Courts ordinarily focus on the "the totality of the circumstances" to analyze what some have called "the ultimate concern [of] whether, as a matter of economic reality, the workers depend upon someone else's business for the opportunity to render service or are in business for themselves."

Historically, the U.S. Department of Labor's guidance has generally tracked the judicial test for employee status. During the Obama administration, the DOL focused on six factors to consider when determining whether an employment relationship exists, and ramped up its enforcement efforts to combat misclassification. The agency framed the relevant factors as follows:

1. The extent to which the work performed is an integral part of the employer's business.
2. Whether the worker's managerial skills affect his or her opportunity for profit and loss.
3. The relative investments in facilities and equipment by the worker and the employer.
4. The worker's skill and initiative.

5. The permanency of the worker's relationship with the employer.
6. The nature and degree of control by the employer.

We didn't see a lot of activity from the DOL on classification issues during the Trump presidency, consistent with that administration's laissez-faire policies toward the workplace. In the meantime, the gig and on-demand economies continued to explode, and much of the employment lawmaking and policymaking was left to the states and cities.

How We Got Here: The 2021 Rule

On the campaign trail in 2020, Joe Biden made clear, including in his "Empower Workers" platform, that he intended to "[a]ggressively pursue …and put a stop to employers intentionally misclassifying their employees as independent contractors," and to "enact legislation that makes worker misclassification a substantive violation of law under all federal labor, employment, and tax laws with additional penalties beyond those imposed for other violations." Biden also promised to work with Congress to establish a federal standard for independent contractor classification modeled on the "ABC test" for all labor, employment, and tax laws. The ABC test—used as the basis for several states' laws, such as California's AB5 legislation—is the most stringent of various tests used to determine worker status. Under California's test, for example, a worker will be considered an employee unless the company engaging the worker establishes ***all*** of the following three prongs:

1. the worker is free from the control and direction of the company in connection with the performance of the work, both under the contract for the performance of such work and in fact;
2. the worker performs work that is outside of the "usual course" of the company's business; and
3. the worker is customarily engaged in an independently established trade, occupation, or business that is of the same nature as the type of work performed for the company.

In January 2021, in the waning days of the Trump administration, the DOL issued a Final Rule on independent contractor classification, reducing the number of primary factors the agency would consider when determining whether a worker is an independent contractor or an employee to two "core factors"—the nature and degree of control over the work and the worker's opportunity for profit or loss based on initiative and/or investment. Under the 2021 test, other factors—including the amount of skill required for the work, the degree of permanence of the working relationship between the worker and the potential employer, and whether the work is part of an "integrated unit of production"—would generally only be considered when the two "core factors" don't point to the same classification. The rule was set to take effect on March 8, 2021.

Within the first few hours after President Biden's inauguration on January 20, 2021, the White House issued a "regulatory freeze" memorandum to the heads of all executive departments and agencies, requesting that they halt all non-emergency rulemaking and regulatory activity pending review by the new administration and consider postponing by 60 days the effective date of any such rules that not yet taken effect "for the purpose of reviewing any questions of fact, law, and policy the rules may raise."

In March 2021, the Biden DOL issued a Notice of Proposed Rulemaking (NPRM) to withdraw the lame-duck independent contractor rule. In May 2021, the DOL announced the official withdrawal of the rule. In March 2022, a federal district court in Texas held that the withdrawal of the rule was unlawful, and restored it. The DOL appealed the Texas court's decision in May 2022, and later abandoned the appeal so that the agency could engage in new rulemaking regarding independent contractor status.

The New Rule

On October 13, 2022, the DOL issued a proposed new rule on independent contractor classification, largely mirroring the agency's position prior to the Trump administration's 2021 rule. The rule would add a new Part 795 to Title 29 of the Code of Federal Regulations, containing the DOL's "general interpretations for determining whether workers are employees or independent contractors under the FLSA." The rule seeks to wipe clean any lingering impact of the 2021 rule, making clear that "[t]o the extent that prior administrative rulings, interpretations, practices, or enforcement policies relating to determining who is an employee or independent contractor under the [FLSA] are inconsistent or in conflict with the interpretations stated in this part, they are hereby rescinded."

As an overarching principle, the DOL notes that "[a] determination of whether workers are employees or independent contractors … focuses on the economic realities of the workers' relationship with the employer and whether the workers are either economically dependent on the employer for work or in business for themselves." Framing economic dependence as "the ultimate inquiry," the agency notes that the inquiry "does not focus on the amount of income earned, or whether the worker has other income streams." Rather, multiple factors are used to determine economic dependence as part of a "totality of the circumstances" analysis, including:

- ***Opportunity for profit or loss depending on managerial skill.*** This factor considers whether the worker exercises managerial skill that affects the worker's economic success or failure in performing the work. Relevant considerations include whether the worker determines or can meaningfully negotiate the charge or pay for the services provided; whether the worker accepts or declines jobs or chooses the order and/or time in which the jobs are performed; whether the worker engages in marketing, advertising, or other efforts to expand their business or secure more work; and whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space. If a worker has no opportunity for profit or loss, the factor suggests that the worker is an employee. The agency notes that some decisions by a worker that can affect the amount of pay that a worker receives, such as the decision to work more hours or take on more jobs, generally do not reflect the exercise of "managerial skill." In addition, "[w]orkers who incur little or no costs or expenses, simply provide their labor, and/or are paid an hourly or flat rate are unlikely to possibly experience a loss, and this factor may suggest employee status[.]"

- ***Investments by the worker and the employer.*** This factor considers whether any investments by a worker are "capital or entrepreneurial" in nature. The proposed rule is not very clear on what types of investments the DOL has in mind here, citing only those that "generally support an independent business and serve a business-like function, such as increasing the worker's ability to do different types of or more work, reducing costs, or extending market reach." Notably, "[c]osts borne by a worker to perform their job (*g.*, tools and equipment to perform specific jobs …) are not evidence of capital or entrepreneurial investment and indicate employee status."
- ***Degree of permanence of the work relationship****.* This factor supports a determination of employment "when the work relationship is indefinite in duration or continuous, which is often the case in exclusive working relationships." Conversely, the factor supports a finding of independent contractor status "when the work relationship is definite in duration, non-exclusive, project-based, or sporadic based on the worker being in business for themself and marketing their services or labor to multiple entities." That said, "[w]here a lack of permanence is due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ, rather than the workers' own independent business initiative, this factor is not indicative of independent contractor status."
- ***Nature and degree of control.*** This factor considers both active and reserved control (*e.*, the right to control) by the entity receiving the services over "the performance of the work and the economic aspects of the working relationship." Relevant facts include whether the engaging entity:
  - sets the worker's schedule;
  - supervises the performance of the work, or reserves the right to supervise or discipline the worker;
  - explicitly limits the worker's ability to work for others, or places demands on the workers' time that do not allow them to work for others or work when they choose;
  - uses "technological means of supervision (such as by means of a device or electronically)"; and
  - controls the prices or rates for services and the marketing of the services or products provided by the worker.

The DOL notes that "control implemented by the [engaging entity] for purposes of complying with legal obligations, safety standards, or contractual or customer service standards may be indicative of control."

- ***Extent to which the work performed is an integral part of the employer's business.*** This factor does not depend on whether any individual worker in particular is an integral part of the business, but rather whether the *function* the worker performs is an integral part—*e.*, whether it is "critical, necessary, or central to the [engaging entity's] principal business."
- ***Skill and initiative*.** This factor considers "whether the worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative." It supports employee status where the worker does not use specialized skills in performing the work or "where the worker is dependent on training from the employer to perform the work."

The DOL notes that "[a]dditional factors may be relevant in determining whether the worker is an employee or independent contractor … if the factors in some way indicate whether the worker is in business for themself, as opposed to being economically dependent on the employer for work."

Some Observations

- ***Take That!*** The proposed rule includes some language that is clearly responsive to arguments raised by employers in misclassification cases, as well as to certain practices in the on-demand services industry. For example:
  - Under the "opportunity for profit and loss" factor, the agency rejects the proposition that a worker's decision to take on additional hours or tasks indicates "managerial skill."
  - Under the "investments" factor, the DOL notes that "the use of a personal vehicle that the worker already owns to perform work—or that the worker leases as required by the employer to perform work—is generally not an investment that is capital or entrepreneurial in nature."
  - Under the "control" factor, the DOL rejects the notion that control required for compliance with legal obligations, safety standards, or contractual or customer service standards is necessarily a neutral factor. This position is in stark contrast to the 2021 rule, which states that an employer requiring a worker to "comply with specific legal obligations, satisfy health and safety standards, carry insurance, meet contractually agreed-upon deadlines or quality control standards, or satisfy other similar terms … does not constitute control that makes the [worker] more or less likely to be an employee."
  - Also under the "control" factor, the DOL will deem the use of "technological means of supervision"—*g.*, the GPS tracking enabled in some on-demand

platforms, or task management software—as relevant.

  - Under the "integral" factor, the DOL's focus on whether the function itself is "critical, necessary, or central" to the engaging entity's principal business—as opposed to whether the workers themselves are integrated—hones closer to the second prong of the ABC test than earlier iterations of the federal standard. The agency notes that "if the [engaging entity] could not function without the service performed by the workers, then the service they provide is integral."
  - Under the "skill and initiative" factor, the DOL cites to court decisions finding that the work of security guards, janitors, drivers, landscape workers, and call center workers do not require specialized skills. In addition, in the view of the agency, "the worker's use of [independent business-like] initiative in connection with any specialized skills"—as opposed to the skills alone—"is more probative of the ultimate inquiry of whether the worker is economically dependent on the business."

- ***Will It Matter?*** As the DOL concedes, the courts are the ultimate arbiters of whether a particular individual or group of individuals are employees or independent contractors. In its introductory statement in proposed 29 C.F.R. § 795.100, the DOL describes the proposed rule as containing its "general interpretations" for determining worker status. If the courts grant the rule the same measure of deference as they do with other "interpretive" rules, the weight they will afford the rule should depend on "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade"—as explained by the Supreme Court in *Skidmore v. Swift Co.* Having waited nearly two years to revisit the issue of independent contractor classification, the Biden administration clearly took its time to propose a rule it believes is well-grounded and defensible.
- ***Don't Forget the States.*** Employers that remain confident in their independent contractor classification under the proposed rule must still contend with the various states that follow a more stringent or otherwise different test for worker status, including (among others) California, Massachusetts, and New Jersey.

Public comment on the proposed rule is due by December 13 (following a 15-day extension). As of today, the DOL has received 12,469 comments, and we expect many more before the deadline. Given the volume of comments, we expect the DOL to issue a final rule no earlier than the first quarter of 2023.

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