Updates
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US Department of Labor Issues Notice of Proposed Rulemaking on Independent Contractor/Employee Worker Classifications

The U.S. Department of Labor (DOL) issued its Notice of Proposed Rulemaking (NPRM) on September 22, 2020, seeking to codify the independent contractor/employee worker classifications into the Fair Labor Standards Act's regulations. The NPRM represents a unique move by DOL's Wage and Hour Division as previous efforts to provide guidance on independent contractor status has been through less formal administrative methods, such as fact sheets and other sub-regulatory guidance.

According to DOL, the proposal seeks to simplify the employee status inquiry by relying chiefly on two elements of the economic reality test: (1) the nature and degree of the individual's control over the work and (2) the individual's opportunity for profit and loss. By focusing on the nature of the individual's work, rather than the company's explicit or implicit structuring of the workplace, companies will be able to more easily meet the test to establish independent contractor status under the Fair Labor Standards Act (FLSA). Companies, particularly those in the gig economy, may welcome this broader approach to the independent contractor/employee test. However, the test will remain complex and require a case-by-case analysis of the facts. The DOL has given the public 30 days to comment on the proposal.

What are the specifics of the proposal?

DOL's proposed rule is grounded in the FLSA's definition of "employ" which is defined as "to suffer and permit to work." 29 U.S.C. 203(d). Workers outside of the definition are not covered by the minimum wage and overtime obligations of the FLSA. As such, those workers may be properly classified as independent contractors. According to the agency, federal courts have applied the economic reality test as the appropriate measure to distinguish between independent contractors and employees. That test, however, has evolved throughout the years and DOL's proposal concludes that the test has become inconsistent and unwieldy. Moreover, the agency believes that the test is outdated in the context of the modern economy where transaction costs have decreased and worker options have increased.

To simplify the inquiry, the DOL proposes a weighted inquiry to determine economic dependence focused on two core factors: (1) the nature and degree of the individual's control over the work and (2) the individual's opportunity for profit or loss. The proposal claims that a substantial likelihood exists that the distinction between employees and independent contractors can be settled by applying these two factors. Importantly, however, these two "core factors" are afforded greater weight in the analysis but are not the only factors in the test. The agency notes that secondary factors may be considered, including the following:

- the amount of skill required for the work;
- the degree of permanence of the working relationship between the individual and the potential employer; and
- whether the work is part of an integrated unit of production.

DOL settled on these secondary factors after determining that they were the least duplicative of other factors in the various iterations of the economic reality test used by courts currently in the independent

contractor/employee distinction under the FLSA. The proposed rules also state that, in evaluating the economic dependence on the company, the "actual practice of the parties" rather than what may be "contractually or theoretically" possible is more relevant.

What does the DOL proposal mean for companies?

The proposal is in line with DOL's desire to address previous efforts by past administrations to expand the definition of "employee." The proposal follows the DOL's 2019 opinion letter setting forth an "easier" standard for establishing independent contractor status by determining that client service providers for a virtual marketplace company were properly independent contractors. These inquiries place the focus on the worker's level of economic independence rather than a company's control of the relationship.

The DOL proposal, however, does not create any bright lines nor include practical examples of how companies should apply the standards. Should the proposal pass as is, analysis of the primary two factors will continue to be complex and fact specific.

Importantly, this DOL proposal will provide little clarity to California companies and companies in other states utilizing the ABC test. For example, in California, there have been multiple legislative efforts regarding the use of the ABC test to distinguish independent contractors from employees. Further discussion of the most recent version of the California ABC test, found in AB 2257, can be reviewed here.

What's are next steps?

We anticipate that the DOL proposal will move forward quickly, and a final rule could come as soon as January 2021. The DOL has set out a 30-day comment period. While some members of U.S. Congress have criticized the short comment period, Congress is unlikely to be able to extend the comment period.

As this is a high-stakes rulemaking, we anticipate the number of comments to exceed the 293,394 comments submitted when DOL attempted to raise the salary basis test to $48,000 under the Obama administration. Like that rulemaking (as with DOL's regulations implementing the Families First Coronavirus Response Act (FFCRA)), a court challenge is almost certain. Further, the rule will be subject to the legal requirements in place to foreclose "midnight" rulemaking late in a presidential term. The Congressional Review Act (CRA) allows Congress to strike down rules promulgated late in an administration in its subsequent session. Should Republicans lose control of the White House and Senate, a Democratic-controlled Congress could successfully rescind the rule under the CRA.

Takeaways

Companies utilizing independent contractors or that desire to utilize independent contractors should consult with legal counsel regarding the independent contractor/employee determination to make sure that the company is current on the latest developments in this ever-evolving area of the law.

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