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US Department of Labor Issues Proposed Rule on Independent Contractor Status

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On October 11, 2022, the Department of Labor (DOL) announced a **proposed rule that would reinstate the "economic reality" test** for determining whether a worker is an independent contractor or an employee under the Fair Labor Standards Act (FLSA).

The DOL stated that the proposed rule would create a framework that is more consistent with the FLSA's text and purpose as interpreted by courts that have applied the economic reality test. In addition, the DOL noted that the proposed rule would both preserve essential worker rights and provide for more consistency for employers, stating that the rulemaking is "not intended to disrupt the businesses of independent contractors who are, as a matter of economic reality, in business for themselves."

The public has until December 13, 2022, to **comment on the proposed rule online** or via mail.

Background

As we previously **discussed in a January 2021 client alert**, the DOL published a final rule during the Trump administration regarding the classification of independent contractors under the FLSA (2021 IC Rule). That rule adopted a five-factor test to assess a worker's economic dependence, emphasizing two core factors – the nature and degree of the worker's control over the work and the worker's opportunity for profit or loss – as the "most probative as to whether or not an individual is an economically dependent 'employee.'"

However, in March 2021, the DOL under the Biden administration published a rule delaying the effective date of the 2021 IC Rule, then later withdrew it in its entirety. In mid-March, a federal district court in the Eastern District of Texas vacated the withdrawal of the rule, restored the original rule and concluded that the 2021 IC Rule became effective on the original effective date of March 8, 2021. The DOL's proposed rule now seeks to rescind the 2021 IC Rule and return to principles previously adopted by the Obama administration.

Proposed rule adopts six-factor economic reality test

The "economic reality" test long applied by courts examines whether workers are economically dependent on their employer for work, or whether they're truly in business for themselves. The DOL's proposed rule adopts a multifactor, totality-of-the-circumstances analysis of the economic reality test to determine whether a worker is an employee or an independent contractor under the FLSA. In this analysis, the factors analyzed do not have any predetermined weight, and no one factor is dispositive.

Although the proposed rule focuses on six factors, as described below, the agency notes that additional factors may be relevant in the analysis if the factors in some way indicate the worker is in business for themselves, as opposed to being economically dependent on the employer.

Factor #1: Opportunity for profit or loss depending on managerial skill

This factor borrows from one of the "core" factors of 2021 IC Rule by focusing on assessing the degree to which a worker's managerial skill affects the worker's economic success or failure in performing the work. However, unlike the approach in the 2021 IC Rule, the DOL now proposes to consider investment as a separate factor in the analysis. Relevant considerations in applying this factor include:

- Whether the worker determines the charge or pay for the work provided (or at least can meaningfully negotiate it).
- Whether the worker accepts or declines jobs, or chooses or can meaningfully negotiate 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.
- Whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space (as opposed to the amount and nature of the worker's investment).

The DOL also notes that whether the worker actually has an opportunity for a loss should be considered, because doing so may indicate independent contractor status, whereas workers who incur little or no costs or expenses, simply provide their labor, or are paid an hourly or flat rate are unlikely to experience a loss, suggesting employee status.

Factor #2: Investments by the worker and employer

As mentioned above, the proposed rule now considers investment as a stand-alone factor in the economic reality test, to align with the approach taken by most courts. This factor analyzes whether a worker's investment is "capital or entrepreneurial in nature," which supports independent contractor status. Relevant investments can include those that increase the worker's ability to do different types of or more work, reduce costs, or extend market reach, suggesting that the worker is in business for themselves. However, costs borne by the worker simply to perform the job, such as tools and equipment, are not evidence of capital or entrepreneurial investment. Notably for gig economy employers, the proposed rule states 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," because such a vehicle is often used for personal reasons or was purchased for personal purposes.

The proposed rule also notes that a worker's investments should be evaluated on a relative basis with the employer's investments, in line with the approach taken by circuit courts. Where a worker's investment does not compare favorably to the employer's investment, it suggests that the worker is economically dependent and therefore an employee.

Factor #3: Degree of permanence of the work relationship

This factor analyzes whether the work relationship is indefinite or continuous, which suggests employee status, versus sporadic or project-based, which suggests independent contractor status. However, the DOL emphasizes that a worker's lack of permanent or indefinite relationship does not necessarily indicate independent contractor status if it does not result from the worker's own independent business initiative. In addition, the DOL notes that a lack of permanence may be inherent in certain jobs, such as temporary and seasonal work, which does not necessarily imply independent contractor status. While a worker working exclusively for a particular employer speaks to the permanence of the work relationship, the proposed rule cautions that courts have found that workers not relying on their employers as their exclusive or primary source of income does not indicate whether an employment relationship exists, because many workers in the modern economy routinely seek out more than one source of income.

Factor #4: Nature and degree of control

Unlike the 2021 IC Rule, which designated this as a "core" factor, the DOL's proposed rule de-elevates this factor to just one of its

six-factor analysis. This factor focuses on the level of control maintained by an employer over “meaningful economic aspects of the work relationship.” Relevant considerations in analyzing this factor include whether the employer sets a worker’s schedule, supervises performance of work (including the ability to assign work), the worker’s ability to set a price or rate for goods or services provided by the worker or to influence the price or rate, and the worker’s ability to work for others. Additionally, the proposed rule indicates that employers may exercise control mediated by technology. The DOL notes that supervision can be maintained in many different ways that may not be obvious, including remotely through technology: Employers can remotely supervise their workforces, for instance, by using electronic systems to verify attendance, manage tasks or assess performance. Employers also can implement monitoring systems that can track a worker’s location and productivity, and even generate automated reminders to check in with supervisors.

In addition, control can be indicated where an employer complies with legal obligations, safety or health standards, or requirements to meet contractual or quality control obligations, suggesting that the worker is economically dependent on the employer.

Factor #5: Extent to which the work performed is an integral part of the employer’s business

This factor considers whether work is critical, necessary or central to the employer’s business: Where a worker’s performance of work is integral to the employer’s business, it suggests employee status, whereas a worker who performs work that is more peripheral to the business is more likely to be independent from the employer. The proposed rule emphasizes that the critical question is whether the worker performs work that is central to the employer’s business, not whether the worker possesses unique qualities that “render them indispensable as an individual.” For example, an operator who is one of hundreds or thousands of operators at a call center is still an integral part of the employer’s business “even if that one worker makes a minimal contribution to the business when considered among the workers as a whole.”

Factor #6: Skill and initiative

This factor considers whether a worker uses specialized skills to perform work and whether those skills contribute to business-like initiative that is consistent with the worker being in business for themselves instead of being economically dependent on the employer. A worker lacks specialized skills if they are dependent on training from the employer to perform the work, or where the work itself requires no training. In contrast, independent contractor status is suggested where a worker’s specialized skills also demonstrate that the worker exercises independent business judgment.

Impact on employers

Although the proposed rule is not finalized, it reflects an intent to return to the Obama administration’s more rigid approach to independent contractor classification. The proposed rule, if finalized, would make it difficult for certain workers to qualify as independent contractors under the FLSA, and it stands to have a significant impact on gig workers and other service workers under that statute. However, notably, the proposed rule only applies to the FLSA, and the battlegrounds for worker classification overwhelmingly arises out of tax audits and unemployment insurance disputes at the state level. Thus, while this rule is less favorable for businesses using independent contractors, its practical effect will be relatively less dramatic.

We will continue to monitor developments on the proposed rule. If you have any questions about the proposed rule, please reach out to a member of the Cooley employment team.

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