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DOL Proposes to Scrap Employer-Friendly Independent Contractor Rule

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03.18.2021

The Department of Labor (DOL) has officially published its notice proposing to withdraw the new rule – issued two weeks before the change in Presidential Administrations – allowing employers to more easily classify workers as independent contractors under federal law. The rule, entitled "Independent Contractor Status under the Fair Labor Standards Act," was considered a major win for employers, and specifically for companies involved in the gig economy.

Under the Fair Labor Standards Act (FLSA), an employer is required to pay its *employees* at least the federal minimum wage, provide overtime pay in any workweek that an employee works more than 40 hours, and keep and preserve certain records regarding employees. Because the FLSA applies only to employees, an employer does not have to follow the law's minimum wage, overtime pay, or recordkeeping requirements for its independent contractors. In recent years, however, there have been a growing number of challenges by contract workersclaiming a right to collect minimum wages and overtime pay on the basis that they should be considered employees. The new DOL rule would have provided more security for employers facing these challenges, but the new Administration has moved to withdraw the rule as contrary to existing law.

The Supreme Court and federal courts throughout the country use the "economic reality test" to distinguish between independent contractors and employees for purposes of the FLSA. Under the test, it is the economic realities of the relationship between the worker and the employer that are indicative of a worker's status as an independent contractor or employee. In 1947, the Supreme Court stated that six specific factors are relevant to the analysis:

1. The nature and degree of control by the employer;
2. The worker's opportunity for profit or loss;
3. The worker's investment in equipment or materials required for his or her task;
4. Whether the service rendered requires an essential skill;

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5. The degree of permanence of the working relationship;
6. The degree to which the services rendered are an integral part of the employer's business.

United States v. Silk, 331 U.S. 704 (1947).

In the years since *Silk*, federal courts have used variations of the multifactor approach above, with no one factor being dispositive. Likewise, the DOL has conformed to the multi-factor analysis for many years. The DOL's primary sub-regulatory guidance addressing the topic, "Fact Sheet 13: Employment Relationship Under the Fair Labor Standards Act (FLSA)," states that the appropriate test to use is the "economic reality" test and lists seven factors to be considered, which are similar to those used by federal courts—including identifying the worker's "degree of independent business organization and operation."

The DOL's new rule, originally published on January 7th, modified the economic reality test from its intensive, fact-based multifactor approach to a simpler analysis focusing on two core factors: (1) the nature and degree of the putative employer's control over the work, and (2) the worker's opportunity for profit or loss. Under the rule, if these two factors point to the same classification, there is a "substantial likelihood" that it is the accurate classification. Although the rule identifies three other factors for consideration (worker's investment, skill, and degree of permanency of the working relationship), these factors are less probative and "highly unlikely" to outweigh the combined probative value of the two core factors.

In its notice to withdraw the rule, the DOL observed that no court has taken the rule's approach in analyzing whether a worker is an employee or an independent contractor under the FLSA. In fact, the DOL noted that it is not aware of any court that has, as a general and fixed rule, elevated a subset of the economic reality factors over the others, "and there is no clear statutory basis for such a predetermined weighting of the factors." Moreover, elevating two factors may be inconsistent with the position, expressed by the Supreme Court and circuit courts across the country, that no single factor in the analysis is dispositive. Accordingly, the DOL's proposal to withdraw the rule rests, in part, on the position that the rule is inconsistent with the existing law.

The proposed withdrawal proposal also states that the rule improperly narrows the application of the economic reality test to exclude important facts that are ordinarily considered when determining a worker's status as an independent contractor or employee. For example, under the rule, comparing an individual worker's investment to an employer's investment would not be part of the analysis even though numerous Courts of Appeals, and the DOL itself, have engaged in such a comparison in the past. The rule also erases the consideration of a worker's lack of capital investment or lack of managerial skill in certain instances, although both factors are "longstanding and well-settled" indicators of employee status.

Most important to note are the DOL's overarching policy concerns – likely the primary driver of the Department's decision to withdraw the rule. In its proposed withdrawal, the DOL states that the rule's narrowing would result in more workers being classified as independent contractors not entitled to the FLSA's

protections, contrary to the FLSA's purpose of broadly covering workers as employees. The rule may also have a disproportionate impact on low-wage and vulnerable workers, given that women and people of color are overrepresented in low-wage independent contractor positions. The Department cited a report which found that 42% of "gig economy or platform workers" and 45% of "self-employed sole proprietors" make less than $20,000 a year.

In its proposal to withdraw the rule, the DOL has not offered any new regulatory guidance to replace the standards that the new rule would have introduced. Unless and until the DOL does so, employers will have to rely on the DOL's previous guidance, such as that contained in Fact Sheet 13, when classifying workers as independent contractors or employees. Employers who misclassify employees may be liable for significant damages under both federal and state law and should review the law in their respective jurisdictions to ensure accurate classification.

For more information on this subject, or assistance with compliance review, contact any of the attorneys in our Labor, Employment, and Employee Benefits group.

Tags: Fair Labor Standards Act (FLSA), Independent Contractor, U.S. Department of Labor