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Alert | Labor & Employment

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Department of Labor Proposes to Reinstate Economic Realities Test for Independent Contractors Under FLSA

UPDATE: *On Oct. 25, 2022, the Department of Labor extended the comment period for its new proposed rule. The comment period was originally set to expire Nov. 28, 2022, but interested parties will* ***now have until Dec. 13, 2022, to submit comments.***

Go-To Guide:
• Proposed reinstated rule would rescind the independent contractor rule adopted under the Trump administration.
• Economic Realities Test would be reinstated under the new rule.
• The Noticed of Proposed Rulemaking analysis language may affect independent contractor determination in the Gig industry.
• Rejection of current "integrated unit" analysis.

On Oct. 11, the United States Department of Labor (DOL) issued a proposed rule that would change the definition of "independent contractor" for companies, a modification that could impact worker classification across various industries. Essentially, the Notice of Proposed Rulemaking (NPRM) repeals the Trump administration's independent contractor rule and reinstates the principal factors used in the

"economic realities" test. However, the NPRM's analysis of these factors may affect a worker's classification going forward.

Current Independent Contractor Rule

Just prior to the end of the Trump administration, the DOL issued a new rule changing the test used to classify independent contractors. The rule imposes a less stringent test for independent worker classification. The Trump administration test focuses primarily on two core factors: 1) the nature and degree of control over the work; and 2) the worker's opportunity for profit or loss based on initiative and investment ("2021 IC Rule").

The Biden administration tried to withdraw the 2021 IC Rule, but the Fifth Circuit Court of Appeals reinstated it, ruling in *Coalition for Workforce Innovation, et al v. Secretary Walsh et al*. that the DOL's delay, and withdrawal was arbitrary and capricious in not considering alternatives to recission of the rule. Thus, the current rule applies a simpler analysis of a worker's status.

Current Proposed Economic Realities Test

At first glance, the NPRM looks to reinstate the traditional economic realities test used before the 2021 IC Rule change. The NPRM looks to the worker's "economic dependence" on a company for work, as opposed to the worker being dependent upon herself for work. A "totality of the circumstances" is analyzed in determining a worker's classification, with no identified factor given more weight than any other.

The NPRM espouses seven factors to be weighed in determining a worker's status.

1) Opportunity for profit and loss due to the worker's managerial skills: This factor essentially analyzes whether the worker's success or failure is dependent upon the worker's ability to set rate of pay; discretion as to jobs accepted and performed; ability to expand business based upon the worker's marketing, advertising, or other efforts; and ability to make decisions about staff, infrastructure, and overhead. In sum, the analysis under this factor is whether circumstances other than rate of pay can and/or will result in the worker suffering financial loss or gain.

2) Investment by worker and the company: This factor looks to the amount and significance of the worker's investment in his/her own business from an entrepreneurial perspective. This investment is weighed against the investment or provision of capital by the company that allows the worker to perform his/her job. If the worker's investment is not viewed favorably against that of the company, this "suggests that the worker is economically dependent and an employee of the employer."

   Of particular note for those in the gig economy, the NPRM states that it considers nature and reason for the worker's investment. The NPRM, in expanding upon cases cited from the Fifth and Sixth Circuits Court of Appeals, 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."

3) Degree of Permanence of the Relationship: This factor looks at the tenure and duration of the relationship between worker and the company. This an analysis of whether the engagement is exclusive and definitive in term. A contract that "routinely or automatically" renews or a

relationship that is exclusive between a worker and a company leans toward an employer/employee relationship.

Of note, for companies that engage seasonal or project-based contractors, the NPRM states that "operational characteristics that are unique or intrinsic to the particular businesses or industries and the workers they employ" that, by definition, render the relationship or engagement temporary, do not create a contracting relationship *per se*.

4) Nature and Degree of Control: This factor takes into account four key aspects of the relationship in determining whether the requisite degree of control exists to negate a contracting relationship: (1) scheduling (can the company negatively impact the worker for declining work; do the work hours requested inhibit the worker from working with others); (2) compliance with legal obligations (a company exerting control to ensure compliance with legal obligations, safety, or health standards may implicate an employer-employee relationship; if the worker has an entrepreneurial responsibility for understanding and complying with legal and other aspects of performing services, the worker may be viewed as a contractor); (3) pricing (if a worker's rate of pay is set or the worker is not able to negotiate the rate of pay in a meaningful way, the engagement may be indicative of an employer/employee relationship); and (4) ability to work for others (a worker's inability to work for others is indicative of an employer/employee relationship).

5) Extent of Work Performed as Integral to the Company Business: This factor looks to whether the company's business is dependent on the services performed by the worker or, on the other hand, whether the worker's services depend upon the company's business. If both the company and worker are integral to each other, then an employer/employee relationship is probable.

   The NPRM's analysis of this factor notes that it is a direct rejection of the 2021 IC Rule's "integrated unit" factor that assesses whether the duties or services performed by the worker are part of an integrated production unit, e.g., assembly lines type duties or services.

   Notably, the NPRM states that "if the employer could not function without the service performed by the workers, then the service they provide is integral. Such workers are more likely to be economically dependent on the employer because their work depends on the existence of the employer's principal business, rather than their having an independent business that would exist with or without the employer." The NPRM further states that "[a]n individual worker who performs the work that an employer is in business to provide but is just one of hundreds or thousands who perform the work (such as one operator among many at a call center) is nonetheless 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."

6) The Worker's Skill and Initiative: This factor assesses whether the worker is utilizing specialized skills to perform services, including whether the worker is investing as an entrepreneur into developing or acquiring skills to perform a service. The NPRM indicates that "driving" is not a specialized skill.

7) Catch-All for Other Extenuating Factors: This is an undefined factor, but it allows for consideration of individualized factors that may be determinative of either contractor status or an employer/employee relationship.

What Now?

There is a 45-day comment period for entities and individuals to submit comments on the Proposed Rule to the DOL. Comments must be submitted on or before Nov. 28, 2022. Barring any substantial changes after the comment period, companies will need to review worker classifications because, although the factors analyzed in the Proposed Rule are similar to the pre-2021 factors, the discussion of the DOL's assessment of each factor implicates a possible reclassification of some workers. The need to possibly reclassify workers after implementation of the Proposed Rule is contrary to the DOL comments on the NPRM.

Nevertheless, the Proposed Rule is not as restrictive as some state laws, such as the California ABC test, with which employers must comply as well. And employers should note that where a state law is more restrictive than the federal rule, the employer must comply with the more restrictive state law. Employers in states that adopt the FLSA's independent contractor definition may want to assess their worker classifications and respond to the NPRM, including submitting comments regarding the same.

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