Proposed Federal Rule Aims To Make It Easier To Classify Workers As Independent Contractors

Insights
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What Happened? The Department of Labor just issued a new proposed rule that would make it easier for workers to be classified as independent contractors.

What Does It Mean? The proposed test – which would take effect after a 30-day comment period and DOL publishing the final rule – looks to the "economic reality" of each workplace relationship by weighing five simple factors and determining whether the worker is in business for themselves (and thus a contractor) or economically dependent on the hiring entity (employee). Two of the five factors are identified as the "core factors" in the analysis: 1) the extent of control exercised over key aspects of the work; 2) and the opportunity for profit or loss.

What Should You Do? Stay tuned for developments over the next month (and perhaps beyond) to see if the rule goes into effect or is stalled by litigation. If it does take effect, it may be time to revisit your business models to determine whether you can take advantage of the rule – while keeping in mind any state laws that may create a higher barrier for independent contractor status.

Businesses that use independent contractors to carry out critical work roles – especially gig economy companies and those using gig-economy-like strategies for components of their workforce – received a jolt of good news this morning when the Department of Labor unveiled a proposed rule that will make it easier for workers to be classified as contractors. At the same time, the simplified rule will raise the bar and make it harder for disgruntled workers to claim they have been misclassified and should be treated as employees, reducing the chances of a costly judicial finding or expensive settlement in a minimum wage or overtime lawsuit.

The proposed test –– looks to the "economic reality" of each workplace relationship by weighing five simple factors and determining whether the worker is in business for themselves (and thus a contractor) or economically dependent on the hiring entity (employee). Businesses shouldn't celebrate quite yet, however. This proposed rule was developed with rocket speed and will almost certainly be challenged by worker advocates (and perhaps state attorneys general) with the hopes of stalling it past Election Day. Moreover, even if the rule gets put into place as proposed, it will not overturn worker-friendly state laws like California's AB5 and the infamous ABC Test which make it quite difficult for businesses to rely upon contract labor for many jobs.

What do employers need to know about today's announcement?

New 5-Factor Test

Under the DOL's proposed rule, a worker would be considered an employee under the federal Fair Labor Standards Act (FLSA) if, as a matter of economic reality, they are **economically dependent** on a hiring entity for work. On the other hand, an individual would be considered an independent contractor, if, as a matter of economic reality, they are **in business for themselves**. The DOL lays out five factors to examine in making this determination, and while the list is non-exhaustive and no single factor is dispositive, **the first two are considered the most probative** and therefore should be afforded greater weight than any other factor. The DOL notes that if the first two factors are both in favor of one status or the other (employee or contractor), the remaining factors will not be relevant in most cases.

1. ***The Nature And Degree Of The Individual's Control Over The Work***
   A worker is more likely to be considered an independent contractor if they exercise substantial control over key aspects of the performance of the work. The DOL lists activities to be examined under this factor, including setting their own schedule, selecting their own projects, and working for others – including potential business competitors. "Requiring the individual 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 that are typical of contractual relationships between businesses (as opposed to employment relationships) does not constitute control that makes the individual more or less likely to be an employee under the Act," the agency says.
2. ***The Individual's Opportunity For Profit Or Loss***
   If the worker has an opportunity to earn profits or incur losses based on their exercise of initiative (such as managerial skill or business acumen or judgment) or management of their investment in or capital expenditure on helpers, equipment, or material to further their work, they are likely to be considered an independent contractor. If, on the other hand, the worker is only able to positively affect their earnings by working more hours or more efficiently, they are more likely to be considered an employee.
3. ***The Amount Of Skill Required For The Work***
   If the work at issue requires specialized training or skill not provided by the hiring entity, that would weigh in favor of contractor status. But if the job requires no specialized training or skill, and the worker is dependent on the hiring entity to equip them with the necessary skills or training to do the work, the factor would weigh in favor of employee status.
4. ***The Degree Of Permanence Of The Working Relationship***
   If the work is, by design, definite in duration or even sporadic, this factor would weigh in favor of contractor status. Think discrete tasks or jobs (gigs, as it were). However, the rule says that the seasonal nature of work wouldn't necessarily tilt the balance toward a contractor designation. On the other hand, then, work that is indefinite in duration or continuous by design would weigh in favor of the worker being classified as an employee. Notably, the DOL intentionally removed the element of exclusivity from this factor, even though it has previously been analyzed in other permanence inquiries. Thus, while the issue of whether the individual works exclusively for one

entity or works for multiple entities remains important to the overall inquiry, it is best analyzed under a different factor of this test — namely the "control" factor.

5. ***Whether The Work Is Part Of An Integrated Unit Of Production***
   This factor weighs in favor of the individual being an employee to the extent their work is a component of the hiring entity's integrated production process for a good or service. On the other hand, this factor weighs in favor of contractor status to the extent the work is segregable from the potential employer's production process. Making sure this is not to be confused with Prong B of the notorious ABC Test, the DOL explicitly says that "this factor is different from the concept of the importance or centrality of the individual's work to the potential employer's business." Thus, under the DOL's interpretation of this element, a contractor may provide services that are part of the hiring entity's core functions, so long as the contractor is not imbedded into the entity's production process.

Anything Else Of Note?

The agency notes that when evaluating the individual's economic dependence on the potential employer, "the actual practice of the parties involved" is more relevant than what may be contractually or theoretically possible. For example, an individual's theoretical abilities to negotiate prices or to work for competing businesses are less meaningful if, as a practical matter, they are prevented from exercising such rights. "Likewise," the agency says, "a business' contractual authority to supervise or discipline an individual may be of little relevance if in practice the business never exercises such authority." In other words, the DOL's approach does not give significant weight to a party merely reserving a right of control over a contractor.

If this proposed rule is finalized, the DOL reminds us that it would contain the agency's "sole and authoritative interpretation" of independent contractor status under the FLSA. Any other interpretative guidance, opinion letters, or other recommendations to the contrary would be swept away and ignored.

What's Next?

In the next few days, the proposed rule will be officially published in the Federal Register and the 30-day clock for receiving public comment will start ticking. That process must be completed before DOL issues the final rule that becomes the official law of the land. During these 30 days, however, we would not be surprised to see worker-advocacy groups or state attorneys general launch court challenges against the rule in an effort to block implementation. This is especially true given the accelerated process that led this proposed rule to be fast-tracked and unveiled so quickly. If just one federal judge agrees with those challenging the proposal, the rule could be stalled past Election Day. And if a new administration takes control of the White House, the fate of this proposed rule would be uncertain at best.

For these reasons, we don't recommend taking immediate action quite yet to shift your workforce in order to adapt to this new rule. You can use the next month or so to coordinate with your employment counsel to discuss strategies that you might be able to take in order to take advantage

of the key efficiencies baked into this rule should it take hold. Many companies are beginning to pursue alternative business models that utilize contractors to carry out tasks for a portion of their workforce – sometimes slicing off unique segments of their business to be manned by gig-economy-like workers – and this may be an option to consider.

Another topic to discuss with your employment counsel: the nature of any state laws in effect in the jurisdictions in which you do business. Even if this rule takes effect as proposed, it will not change the misclassification framework set in places like California, New Jersey, and Massachusetts. These and other states have established their own systems for examining the contractor question making it quite difficult for companies to utilize contract labor for many jobs within their organization.

We will continue to assess the situation and provide necessary updates, so you should ensure you are subscribed to Fisher Phillips' alert system to gather the most up-to-date information. If you have questions, please contact your Fisher Phillips attorney or any member of our Gig Economy Practice Group.

This Legal Alert provides an overview of a specific agency proposal. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.

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