DOL's New Independent Contractor Rule Could Be DOA

Insights
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The Labor Department finalized a new rule today that aims to make it easier for businesses to classify workers as independent contractors – but the rule faces a very uncertain future given that the Biden administration will take the reins of the federal government before it is scheduled to take effect and the incoming administration has signaled its opposition to this change. 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 – have long awaited this rule in the hopes that it would lend certainty to modern business models and reduce litigation brought by workers claiming to be misclassified as employees. But celebrations need to be put on hold for now, as we expect President-elect Biden to at least temporarily stall implementation past its planned March 8 effective date while worker advocacy groups and state attorneys general line up to file legal challenges in the hopes of permanently killing the rule.

The 5-Factor Rule In A Nutshell

Under the Department of Labor's (DOL's) final rule, a worker will 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. 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

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.
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 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 Labor Department 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.

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What's Next?

The rule is not scheduled to take effect until 60 days have passed from the date it is published in the Federal Register, so federal law will not change in this area until March 8, 2021. But organizations should not plan wholesale changes to their business models around that date. Several significant hurdles await the rule that could see it delayed past then or scrapped altogether.

First and foremost, President-elect Biden will assume office on January 20 and his press secretary has already announced that one of his first actions will be to issue a memo freezing all Trump-era regulations that have not yet taken effect. That December 30 announcement specifically mentioned this independent contractor rule as one that would be stalled by this memo.

While this rule is paused, we expect the courts to get involved. We could see the first legal challenge from some combination of unions, worker advocates, and attorneys general from progressive states seeking to block the rule from taking effect – first on a temporary basis, and then permanently. This is especially true given the accelerated process that led this rule to be fast-tracked and unveiled so quickly. The Biden administration may decide not to put up a challenge to such a lawsuit, agreeing with those seeking to strike it.

That could lead business advocates and other supporters of the gig economy to either take up the fight on the rule's behalf, or even initiate litigation seeking to "un-freeze" the rule. They would most likely point out that the DOL went through a legally valid regulatory process to implement the rule in the first place, quick as it was, and that the new administration cannot just sweep it away on an arbitrary basis.

All of this would be conducted with the backdrop of a new worker-friendly occupant in the Oval Office. Remember, Biden's campaign platform specifically touted that he would put a stop to misclassification, harnessing multiple federal agencies to work together to address independent contractor issues (think the IRS, the DOJ, the EEOC, and the NLRB). It would not be surprising to see the Biden DOL take affirmative steps to suspend the rule for further review and reopen the rulemaking record. This approach would be difficult to challenge, particularly if the new administration ensures that the rule never actually takes effect. We could even see the new DOL take a crack at their own independent contractor rule – which would no doubt tilt the playing field in favor of workers. The likelihood of such an action seems to have increased now that the Democrats appear to have wrested back control of the Senate, which could prompt Biden to nominate a more progressive Secretary of Labor who would take up this cause on his behalf.

What Should You Do?

For these reasons, we don't recommend taking immediate action quite yet to shift your workforce to adapt to this new rule. You can use the next several months 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

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, 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. If this rule somehow survives the gauntlet it will now begin to navigate, you can expect other states to consider implementing their own ABC-like tests.

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, any member of our Gig Economy Practice Group, or any member of our Staffing and Contingent Worker Practice Group.

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

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