Labor Department Proposes to Rescind Flexible Independent Contractor Test and Re-Impose Outdated Standard: 5 Key Questions

Insights
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Any business that retains independent contractors as part of their workforce may have a harder time maintaining their business model under a proposed rule that the U.S. Department of Labor (DOL) just released today. The DOL's current rule on the books — which was issued by the prior administration and has been the source of ongoing litigation — makes it easier to classify workers as independent contractors under federal wage and hour rules. As expected, however, the Biden administration is seeking to rescind that rule and return to a standard that would likely result in more workers being classified as employees. What do you need to know as the DOL works to finalize its proposal? Here are the answers to the five key questions you're sure to have.

1. Why is the Issue Important?
Under the Fair Labor Standards Act (FLSA), employees are entitled to certain benefits such as a minimum wage and overtime premiums. While independent contractors are not entitled to such benefits, they typically enjoy more autonomy to set their own schedules and are treated like a standalone business rather than an employee.

In today's economy, many workers are seeking the flexibility that an independent contractor relationship provides and the opportunity to work for more than one company — and businesses are utilizing the independent contractor model to carry out critical work roles, particularly in light of recent labor shortages.

As more people embrace gig work, misclassification of independent contractors remains a significant risk for employers, and many business groups have argued that current employee-independent contractor models do not fit the 21st-century workforce. Some employer groups have called on Congress to pass a bill that would create a hybrid job classification, particularly for gig workers.

However, some worker advocates and labor unions oppose such a classification, claiming that would short-change gig workers from receiving minimum wage and overtime pay. For now, the old rules apply, and interpretations of those rules vary among the federal appellate courts.

2. What Would Change Under the DOL's Proposed Rule?

While the current test from the Trump administration and the proposal from the Biden administration each look to the "economic realities" of the work relationship, the Trump administration's rule (which is currently in effect) primarily focuses on two "core factors":

- The extent of control exercised over key aspects of the work; and
- The opportunity for profit or loss.

The newly proposed rule seeks to reinstate the more complex multi-factor analysis that focuses on the "totality of the circumstances." Moreover, the new rule seeks to codify the DOL's employee-friendly interpretation of how each of the factors in the test should be applied.

Details of Current Test

The current rule simplifies the traditional economic realities test by weighing five factors and determining whether the worker is in business for themselves (and thus a contractor) or economically dependent on the hiring entity (and thus an employee). The five current factors are:

1. The nature and degree of the individual's control over the work;
2. The individual's opportunity for profit or loss;
3. The amount of skill required for the work;
4. The degree of permanence of the working relationship; and
5. Whether the work is part of an integrated unit of production.

Although the list is non-exhaustive and no single factor is dispositive, the first two points are key to the analysis and are therefore afforded greater weight than the other factors. Thus, if the first two factors are both in favor of one status or the other (employee or contractor), the remaining factors will, in most cases, not be considered.

Moreover, 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.

The Proposed Changes

The Biden administration wants to scrap the use of "core factors" and return to a "totality-of-the-circumstances analysis." The DOL said it would "revert to the longstanding interpretation of the economic reality factors" and "ensure that all factors are analyzed without assigning a

predetermined weight to a particular factor or set of factors." The six factors set forth in the newly proposed rule are:

1. The worker's opportunity for profit or loss depending on managerial skill;
2. The relative amount of investment made by the worker in comparison to investments made by the potential employer (notably, DOL states that worker costs incurred for tools and equipment to perform specific jobs do not count as an investment and "indicate employee status");
3. The permanency of the worker's relationship with the potential employer (the proposed rule states that a work relationship that is "definite in duration, non-exclusive, project-based, or sporadic" indicates a contractor relationship);
4. The nature and degree of the potential employer's control (the proposed rule states that control exercised by the potential employer for compliance with "legal obligations, safety standards, or contractual or customer service standards" could indicate an employee relationship);
5. The extent to which the work performed is an integral part of the potential employer's business; and
6. Whether the worker uses specialized skills indicative of business-like initiative.

In addition, the proposed rule states that "additional factors" that "may be relevant" should also be considered.

3. What Other Rules Apply?

Employers should note that the DOL's test applies only to the FLSA, and many states have their own tests that are applied to state-level wage and hour claims. While some states, such as Arizona, have laws protecting the independent contractor relationship if certain criteria are met, other states have laws making it harder to establish an independent contractor relationship. For example, California and Massachusetts apply a stringent "ABC test." A worker is considered an employee under the ABC test unless the hiring entity establishes all three of these prongs:

1. The worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact;
2. The worker performs work that is outside the usual course of the hiring entity's business; and
3. The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity.

The ABC test makes it much more difficult for many companies to treat workers as independent contractors, and more difficult for businesses to hire smaller, entrepreneurial businesses.

You should also recognize that, at the federal level, the National Labor Relations Board and other agencies may apply different tests than the DOL uses for FLSA cases.

4. What's Next?

The DOL has announced it will accept comments from the public through November 28 before finalizing the rule. While it is not uncommon for the comment period to be extended by several weeks, this revision is a priority for the agency so you can expect any delays to be short-lived.

[Ed. Note: The DOL has extended the comment period through December 13.]

Once the DOL has had a chance to review all comments submitted by businesses, worker advocacy groups, trade associations, and any other members of the public, it will decide whether to revise the proposal before finalization. We expect any such revisions to be minor in nature and not to impact the overall direction of the current proposal.

Once the process is completed, the agency will publish the revised rule, which will become the new law of the land. We expect that to occur in the first quarter of 2023. While it is possible that the rule gets stalled by litigation, businesses cannot rely on such an outcome and need to prepare for the new standard.

5. What Should You Do?

Businesses that rely on use of independent contractors are at substantial risk of having that classification challenged by the DOL or in private litigation, and should proactively take steps to mitigate the risk of a misclassification. Compliance is key for many organizations. Additionally, you can read here about the three steps HR can take to minimize misclassification of gig economy workers.

We will monitor these developments and provide updates as warranted, so make sure that you are subscribed to Fisher Phillips' Insights to get the most up-to-date information direct to your inbox. If you have compliance questions, consult with your Fisher Phillips attorney, the authors of this Insight, or any member of our Wage and Hour Practice Group or Gig Economy Team to assess and minimize potential risks.

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