

U.S. Department of Labor Proposes New Rule to Streamline Independent Contractor Analysis

By Jeffrey W. Brecher & David R. Golder

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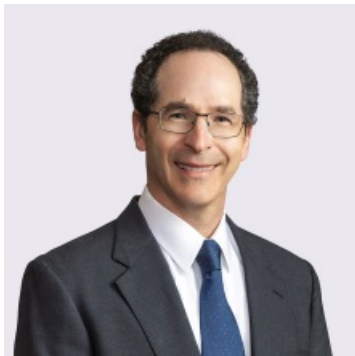
Jeffrey W. Brecher

(Jeff)

Principal and Office Litigation
Manager

(631) 247-4652

Jeffrey.Brecher@jacksonlewis.com



David R. Golder

Principal

(860) 522-0404

David.Golder@jacksonlewis.com

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The U.S. Department of Labor (DOL) has issued a new proposed regulation setting forth the proper standard for determining a worker's status as an "independent contractor" under the Fair Labor Standards Act (FLSA).

According to the DOL, it issued the [Notice of Proposed Rulemaking \(NPRM\)](#) "to promote certainty for stakeholders, reduce litigation, and encourage innovation in the economy." The new proposed regulation identifies two "core factors" that are the "most probative" and should be "afforded greater weight" in the analysis:

1. "the nature and degree of the individual's control over the work"; and
2. the worker's "opportunity for profit and loss."

Three other factors are identified that the proposed rule affords lesser weight.

Comments must be submitted by October 26, 2020, after which the DOL likely will issue a final regulation.

Background

The FLSA guarantees a minimum wage for all hours worked and overtime for any hours worked over 40 per week for all covered, non-exempt employees. As the U.S. Supreme Court first noted more than 70 years ago, individuals who perform services for a company as an independent contractor are not afforded the FLSA's minimum wage and overtime protections because they are not "employees." The FLSA, however, says little about how to distinguish an employee from an independent contractor.

Over the years, both the courts and the DOL have developed similar, yet somewhat varying, standards and factors that should be used for determining whether an individual is an employee or an independent contractor.

The standards developed seek to reveal the "economic reality" of the relationship between the employer and the individual, and are derived from six, non-exclusive factors originally presented by the Supreme Court in two cases on the same day, *United States v. Silk*, 331 U.S. 704 (1947), and *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947).

Those factors are (1) the employer's versus the individual's degree of control over the work, (2) the individual's opportunity for profit or loss, (3) the individual's investment in facilities and equipment, (4) the permanency of the relationship between the parties, (5) the skill or expertise required by the individual, and (6) whether the work is "part of an integrated unit of production."

Federal courts and the DOL have applied these factors inconsistently, sometimes reaching opposite conclusions when applying what appear to be essentially the same facts. The NPRM notes, for example, that a panel of the U.S. Court of Appeals for the Fifth Circuit held that cable splicers hired as independent contractors by BellSouth to provide post-Hurricane Katrina repairs were employees. *Cromwell v. Driftwood Elec. Contractor*,

Inc., 348 Fed. Appx. 57 (5th Cir. 2009). The following year, in a case involving essentially the same relevant facts, a different panel of the Fifth Circuit reached the opposite conclusion. *Thibault v. BellSouth Telecommunications*, 612 F.3d 843 (5th Cir. 2010).

Proposed New Rule

Economic Dependence

The NPRM maintains that the “economic reality” of the relationship between the employer and the worker drives the analysis. That is, “whether, as a matter of economic reality, the workers depend upon someone else’s business for the opportunity to render service or are in business for themselves.”

The Factors

The proposed rule seeks to streamline and clarify the application of the (still non-exclusive) factors that should guide the inquiry and provides a more detailed discussion of how to apply these factors. Significantly, the NPRM proposes to elevate the comparative value of two “core” factors: “the nature and degree of the individual’s control over the work” and “the individual’s opportunity for profit or loss.” While all circuit courts already employ these factors, DOL regulations have not previously identified any factor as entitling to more or less weight. The NPRM notes that when both of these factors support, or contradict, the existence of an independent contractor relationship, courts routinely have relied on them as controlling the determination. The proposed rule states these factors are the “most probative” and therefore should be “afforded greater weight.”

1. Degree of control

The nature and degree of control over the work is a factor that weighs in favor of an independent contractor relationship to the extent that the individual, as opposed to the potential employer, “exercises substantial [even if not exclusive] control over key aspects of the performance of the work,” such as setting work schedules, choosing assignments, working with little or no supervision, and being able to work for others. By contrast, an individual is more likely to be deemed an employee if the employer substantially controls such aspects of the job.

On the other hand, an employer’s requirement that an individual 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” does *not* signify the type of control that would characterize an individual as an employee.

2. The individual’s opportunity for profit or loss and the investment in equipment or facilities

With respect to an individual’s opportunity for profit or loss, the DOL agrees with the general view that this factor involves assessment of “whether such opportunities are based on personal initiative, managerial skill, or business acumen.”

The proposed rule follows the approach of the U.S. Court of Appeals for the Second Circuit, merging the “investment” factor with the “opportunity for profit or loss” factor, rather than analyzing them separately.

In the DOL's view, a comparative investment in equipment or facilities results in a skewed analysis, as it is not uncommon for a large company to have a significantly greater investment in, for example, a manufacturing plant. Instead, the combined factor "would ask whether the worker has an opportunity to earn profits or incur losses based on his or her exercise of initiative or management of investments."

3. The skill or expertise required by the individual

Based on the language of the Supreme Court's opinion in *Silk*, some courts of appeals have defined the "skill required" factor as "the degree of skill required to perform the work," while the DOL and other courts have expanded this factor to include "initiative" and "judgment."

Noting that "the worker's capacity to exercise on-the-job initiative already is analyzed in multiple ways" under the "control" and "opportunity for profit or loss" factors, the DOL believes that including initiative in this factor is redundant. Therefore, the proposed rule omits "initiative" from this factor.

4. The permanency of the relationship between the parties

The "permanence" factor has been recognized as relevant to the independent contractor analysis in that an individual is more likely an independent contractor "where his or her working relationship with the potential employer is by design definite in duration or sporadic," while the individual more likely is an employee where they and the potential employer "have a working relationship that is by design indefinite in duration or continuous."

However, the NPRM proposes to separate the "exclusivity" factor from the "permanence" factor and instead consider exclusivity only as an aspect of the employer's "control." In other words, whether the employer prohibits the individual from obtaining work elsewhere (either simultaneously or subsequently) is relevant only to the employer's level of control. The NPRM further notes, "[T]he seasonal nature of some jobs does not necessarily suggest independent contractor classification, especially where the worker's position is permanent for the duration of the relevant season and where the worker has done the same work for multiple seasons."

5. Whether the work is "part of an integrated unit of production"

Some courts have concluded that an individual is more likely to be deemed an employee under the "integrated unit" factor "if the work performed is so important that it is central to or at the heart of the potential employer's business." The DOL is concerned that focusing on the importance or centrality of an individual's services departs from the Supreme Court's original articulation of the economic reality test, has limited probative value regarding economic dependence, and may be misleading in some instances. Accordingly, the proposed rule identifies, as the fifth factor, "whether the work is part of an integrated unit of production," following *Rutherford Food*.

Takeaway

Because the proposed rule is a formal regulation and not merely "subregulatory" agency guidance (such as an opinion letter or interpretive rule), once finalized, the courts will be required to give it the greater level of deference under the Supreme Court's *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 468 U.S. 837 (1984). Under that

standard, courts generally are required to defer, where reasonable, to agency regulations interpreting ambiguous statutory terms. In this regard, employers may be able to rely on the rule in establishing a “good-faith” defense when facing an independent contractor misclassification claim, providing a basis for avoiding liability even if a court ultimately disagrees with the regulation.

However, the new rule may not affect how states (such as California, under Assembly Bill 5) determine who constitutes an independent contractor under their respective wage and hour statutes. The new rule also would not redefine who an independent contractor is under the Internal Revenue Code, the National Labor Relations Act, or other federal laws.

The DOL has announced a 30-day period for public comment. Any such comments must be submitted no later than October 26, 2020. This relatively short comment period signals that the DOL hopes to finalize the rule by the end of President Donald Trump’s first term. Nevertheless, the new rule could be vacated under the Congressional Review Act if Democrats take control of both the House and Senate following the November elections.

Jackson Lewis attorneys will continue to keep you informed of further developments regarding the proposed rule. In the meantime, if you have any questions about the proposed rule, the independent contractor analysis, or any other wage and hour issue, please consult the Jackson Lewis attorney(s) with whom you regularly work.

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