Special Report

What's Old Is New Again: Labor Department Flip-Flops on Independent Contractor Analysis

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The U.S. Department of Labor (DOL) has issued a Notice of Proposed Rulemaking (NPRM), seeking to revise the standard for determining whether a worker is an employee or "independent contractor" under the Fair Labor Standards Act (FLSA).

In so doing, the NPRM proposes withdrawing the current regulations (the "Trump IC Rule" or "Rule") – issued during the last days of the previous administration and arguably allowing for expanded use of independent contractors – and replacing them with the standards that existed prior to the current regulations, supplemented by some additional clarifications and examples.

This is not the current DOL's first attempt to nullify the Trump IC Rule. Shortly after the Biden Administration took office in January 2021, the DOL first delayed implementing the Trump IC Rule, then withdrew the Rule altogether in May 2021. In March 2022, however, a Texas federal court held that both the delay and the withdrawal were unlawful. As a result, the Trump IC Rule went into effect. With the NPRM, the DOL seeks not only to again withdraw the Trump IC Rule but (unlike its previous effort) to replace the Rule with standards already applied, with minor variations, by a number of circuit courts, along with some additional discussion about how to apply those standards.

The deadline to submit comments to the DOL regarding the NPRM is November 28, 2022.

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." However, the FLSA says little about how to distinguish an employee from an independent contractor.

Over the years, both the DOL and the courts developed similar standards for determining whether an individual is an employee or an independent contractor, most of which focused on the "economic reality" of the relationship between the employer and the individual. Those standards were derived from six, non-exclusive factors originally presented by the Supreme Court in two cases decided on the same day, *United States v. Silk*, 331 U.S. 704 (1947), and *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947). The 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;

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5. The skill or expertise required by the individual; and
6. Whether the work is "part of an integrated unit of production."

While the courts and the DOL have applied these factors, or some similar variation of them, for the last 70-plus years, they have applied these factors inconsistently, sometimes reaching opposite conclusions when applying what appear to be essentially the same facts. This tension led to the adoption of the Trump IC Rule.

Trump IC Rule

In the Trump IC Rule, the DOL elevated the comparative value of the following two "core" factors, rather than treating the factors as having equal weight: "the nature and degree of the individual's control over the work" and "the individual's opportunity for profit or loss." The Trump IC Rule explained that these factors are traditionally the "most probative" and, therefore, should be "afforded greater weight" than the other factors. However, if these "core factors" are inconclusive, it instructed that the following three other factors should be considered: the skill or expertise required by the individual; the permanency of the relationship between the parties; and whether the work is "part of an integrated unit of production." Thus, the Trump IC Rule sought to clarify the tension created by decades of inconsistent and subjective application of the factors.

Nevertheless, shortly after the Biden Administration arrived, the DOL temporarily delayed the Trump IC Rule's March 2021 effective date, then issued an NPRM to withdraw the Rule altogether. In proposing to withdraw the Rule, the DOL asserted that it "is inconsistent with the FLSA's text and purpose, and would have a confusing and disruptive effect on workers and businesses alike due to its departure from longstanding judicial precedent." In lieu of proposing a new rule at that time, however, the DOL simply revoked the Rule, leaving in place the judicially created inconsistencies adopted through the decades.

However, in March 2022, a Texas federal court concluded that the DOL's delay and withdrawal of the Trump IC Rule violated the Administrative Procedure Act, because neither action followed a legally adequate notice-and-comment period. The court also held that withdrawing the Rule was "arbitrary and capricious" because the DOL did not consider alternatives to eliminating the Rule, for example, issuing a revised rule or clarifying what subset (if not all) of the factors should be used in the analysis. Consequently, the court immediately reinstated the Trump IC Rule that the NPRM now seeks to again rescind. The DOL appealed that ruling, but the appeal has been stayed in light of the anticipated issuance of new regulations.

NPRM

Attempting to satisfy the Texas federal court's admonitions, the DOL has issued the NPRM. The NPRM unequivocally abandons the Trump IC Rule's concept of "core factors" and repeatedly explains why the Rule should be withdrawn, noting that such a "predetermined and mechanical weighting of factors is not consistent with how courts have, for decades, applied the economic reality analysis." In lieu of the "core factors" approach, in the NPRM the DOL returns to its longstanding position that the economic reality of the relationship between contractor and alleged employer should be evaluated considering the "totality of the circumstances" and not by weighting or tallying factors.

Instead, the NPRM considers six, equally weighted factors that, with some "slight variation," both the DOL and the federal courts historically have applied. These factors are:

1. The degree of control exercised by the employer over the worker;
2. The worker's skill or initiative;
3. The permanency of the relationship between the parties;
4. The worker's opportunity for profit or loss dependent on managerial skill;
5. The worker's investment in equipment or other resources as compared to the employer's investment; and
6. Whether the work is an integral part of the employer's business.

The NPRM clarifies that in some cases one or more factors may be more probative than others, and in some cases one or more factors may be irrelevant. The NPRM also explains that this approach offers flexibility because, as these six factors are non-exhaustive, other considerations may arise in a given situation.

1. Employer's vs. Worker's Degree of Control

The "control" analysis "focuses on whether the alleged employer still retains control over meaningful economic aspects of the work relationship such that the control indicates that the worker does not stand apart as their own business." Significantly, the NPRM reiterates that it is an employer's *right* to control, even if rarely or never exercised, that guides the determination.

The NPRM summarizes the control factor as follows:

Control can be exerted directly in the workplace by an employer, such as when it sets a worker's schedule, compels attendance, or directs or supervises the work. However, the absence of these more apparent forms of control does not invariably lead to the conclusion that the factor weighs in favor of independent contractor status. Employers may also exercise control in other ways, such as by relying on technology to supervise a workforce, setting prices for services, or restricting a worker's ability to work for others —actions that can exert control without the traditional use of direct supervision, assignment, or scheduling.

The Department believes that the nature and degree of the employer's control should be fully assessed, and this assessment may, in some cases, include consideration of control that is due to an employer's compliance with legal, safety, or quality control obligations. As with all the economic reality factors, this control should be examined in view of the ultimate inquiry: is it probative of whether the worker is in business for themself or economically dependent on the employer for work. For example, when an employer, rather than a worker, controls compliance with legal, safety, or other obligations, it may be evidence that the worker is not in fact in business for themself because they are not doing the entrepreneurial tasks that suggest that they are responsible for understanding and adhering to the legal and other requirements that apply to the work or services they are performing such that they are assuming the risk of noncompliance.

The NPRM notes, for example, that an employer's safety requirement for all individuals to wear hard hats at a construction site is less probative of control than if the employer sets the time and location for weekly safety meetings and mandates that all workers attend. Moreover, while a worker's ability to set their own schedule, in theory, might

demonstrate a lack of control, it would not suggest independent contractor status if, for example, the employer sets limited hours during which the worker may set their schedule, precludes the worker from working for other customers, or disciplines or otherwise penalizes the worker for declining work.

Furthermore, an employer's close supervision of a worker may evince employee status, while the ability to work without close supervision may suggest an independent contractor relationship. However, non-traditional forms of supervision, such as control of a remote worker through computer-based location monitoring and productivity tracking, must be considered.

In addition, whether the worker could set, or influence, the price or rate for the goods or services they are providing is relevant to the control factor analysis, as the worker's ability to do so "relates directly to whether the worker is economically dependent on the employer for work and helps answer the question whether the worker is in business for themself."

Finally, regarding the control factor, the NPRM provides:

Where a worker has an exclusive work relationship with one employer and does not have the ability to work for others, this indicates employee status. Where the employer exercises control over a worker's ability to work for others—either by directly prohibiting other work, for example, through a contractual provision, or indirectly by, for example, making demands on workers' time such that they are not able to work for other employers—this is indicative of the type of control over economic aspects of the work associated with an employment relationship.

Conversely, "the mere fact that an employer allows workers to work for others does not transform an employee into an independent contractor."

2. Worker's Skill and Initiative

The NPRM describes this factor as "whether a worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative that is consistent with the worker being in business for themself instead of being economically dependent on the employer." A worker's lack of specialized skills required for the work would suggest employee status, while the "use of those specialized skills in connection with business-like initiative" indicates independent contractor status. The NPRM explains, "That the work does not require prior experience, that the worker is dependent on training from the employer to perform the work, or that the work requires no training are indicators that the worker lacks specialized skills. Even if the worker possesses specialized skills, this factor may indicate employee status if the work does not require those skills."

However, the presence of specialized skills must be combined with "business-like initiative" in relation to those skills. As an example, the NPRM provides:

A highly skilled welder provides welding services for a construction firm. The welder does not make any independent judgments at the job site beyond the decisions necessary to do the work assigned. The welder does not determine the sequence of work, order additional materials, think about bidding the next job, or use those skills to obtain additional jobs, and is told what work to perform and where to do it. In this

scenario, the welder, although highly skilled technically, is not using those skills in a manner that evidences business-like initiative. The skill and initiative factor indicates employee status.

[By contrast], [a] highly skilled welder provides a specialty welding service, such as custom aluminum welding, for a variety of area construction companies. The welder uses these skills for marketing purposes, to generate new business, and to obtain work from multiple companies. The welder is not only technically skilled, but also uses and markets those skills in a manner that evidences business-like initiative. The skill and initiative factor indicates independent contractor status.

3. Permanence of the Relationship

The NPRM provides that "an indefinite or continuous relationship is consistent with an employment relationship, but [] a worker's lack of a permanent or indefinite relationship with an employer is not necessarily indicative of independent contractor status if it does not result from the worker's own independent business initiative." Moreover, the NPRM states that "a lack of permanence may be inherent in certain jobs—such as temporary and seasonal work—and [therefore] this is not necessarily an indicator of independent contractor status because a lack of permanence does not necessarily mean that the worker is in business for themself instead of being economically dependent on the employer for work."

Furthermore, the "permanence" factor commonly addresses whether the worker's relationship with the employer is exclusive, as such a relationship suggests permanence. However, simply because a worker holds more than one job at a time, or only works irregularly, does not necessarily imply that they are an independent contractor, particularly if these workers "are economically dependent on each employer for work—as compared to a worker who is in business for themself and chooses to market their independent services or labor to multiple entities[.]"

Finally, because exclusivity also may suggest how much control the employer exerts over the worker, the NPRM states (contrary to the Trump IC Rule) that exclusivity will be considered under both the permanence and the control factors.

4. Worker's Opportunity for Profit or Loss Dependent on Managerial Skill

The NPRM states that this factor "focuses … on whether the worker exercises managerial skill that affects the worker's economic success or failure in performing the work." The NPRM sets forth the following facts that may be probative of whether the worker's managerial skill affects the worker's economic success or failure in performing the work:

- Whether the worker determines the charge or pay for the work provided (or at least can meaningfully negotiate it);
- Whether the worker accepts or declines jobs or chooses or can meaningfully negotiate the order and/or time in which the jobs are performed;
- Whether the worker engages in marketing, advertising, or other efforts to expand their business or secure more work; and
- Whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space (as opposed to the amount and nature of the worker's investment).

In summarizing this factor, the NPRM states:

If a worker has no opportunity for a profit or loss, then that fact suggests that the worker is an employee. On the other hand, workers who are in business for themselves face the possibility of experiencing a loss, and the risk of a loss as a possible result of the worker's managerial decisions indicates independent contractor status. Workers who incur little or no costs or expenses, simply provide their labor, and/or are paid an hourly or flat rate are unlikely to possibly experience a loss, and this factor may suggest employee status in those circumstances. The fact that workers may earn more or less at times (and their earnings may decline) depending on how much they work is not the equivalent of experiencing a financial loss .... [A] worker's decision to work more hours (when paid hourly) or work more jobs (when paid a flat fee per job) where the employer controls assignment of hours or jobs is similar to decisions that employees routinely make and does not reflect managerial skill.

5. Worker's Investment vs. Employer's Investment

Unlike the Trump IC Rule, the NPRM treats relative investment as a standalone factor. According to NPRM, not all investments are created equal. To suggest independent contractor status, "the investment borne by the worker must be capital or entrepreneurial in nature," as "[s]uch investments ... generally support an independent business and serve a business-like function, such as increasing the worker's ability to do different types of or more work, reducing costs, or extending market reach, thus suggesting that the worker is in business for themself." By contrast, "costs borne by the worker simply to perform their job (*e.g.*, tools and equipment to perform a specific job and the worker's labor) are not evidence of capital or entrepreneurial investment." Nevertheless, the DOL notes:

The [DOL] understands that independent contractors make both capital investments to generally support their business and investments to perform particular jobs; therefore, the existence of expenses to perform jobs will not prevent this factor from indicating independent contractor status so long as there are also investments that are capital in nature indicating an independent business.

Finally, and again contrary to the Trump IC Rule, the NPRM states that "the worker's investments should be evaluated on a relative basis with the employer's investments." However, "a worker's investment need not be (and rarely ever is) of the same magnitude and scope as the employer's investment to indicate that the worker is an independent contractor." Nevertheless, the worker's investment should be of sufficient magnitude to support the conclusion that the factor supports independent contractor status.

6. Whether the Work is an Integral Part of the Employer's Business

The Trump IC Rule defined this factor as whether the worker's work "is part of an integrated unit of production" of the employer's business, explaining that "the relevant facts are the integration of the worker into the potential employer's production processes" because "[w]hat matters is the extent of such integration rather than the importance or centrality of the functions performed" by the worker. Returning to the historical interpretation of this factor, the NPRM looks at "whether the worker's work is an 'integral part' of the employer's business." In this regard, the NPRM provides:

Most courts adopt a common-sense approach to whether the work or service performed

by the worker is an integral part of the employer's business. For example, 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.

Importantly, the focus of this factor is on the *work*, not the worker: An individual worker who performs the work "that an employer is in business to provide" – even if but one of a hundred, or a thousand, such workers – is nonetheless integral to the business, even if their individual contribution is relatively minimal. The NPRM provides, as an example of an integral worker, a tomato picker who works on a large tomato farm, whereas the accountant at the payroll service who prepares the farm's tax returns would not be integral to the primary purpose of the farm's business.

Takeaway

The NPRM abandons the Trump IC Rule's elevation of certain "core factors" in assessing independent contractor status, and instead returns to a "totality of the circumstances" approach, where the factfinder is free to consider any relevant facts in assessing whether an individual is "economically dependent on their employer for work" or, conversely, is "in business for themselves." While the proposed standard permits flexibility and consideration of all facts, ultimately, it may provide little assistance to courts in trying to distinguish between an employee and an independent contractor.

Jackson Lewis attorneys are available to help evaluate the impact of the proposed regulations on an employer's business operations and encourage impacted companies to comment on the NPRM.

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