LEGAL BULLETIN
January 24, 2024

CONSTANGY BROOKS, SMITH & PROPHETE LLP

Legal Bulletin #1076

HEADS, WAGE AND HOUR & COMPLIANCE LITIGATION PRACTICE GROUP

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Independent Contractor Rule: The 6 "economic reality" factors

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On January 9, the U.S. Department of Labor issued its Final Rule addressing how to determine whether a worker is properly classified as an "employee" or as an "independent contractor" under the Fair Labor Standards Act.

This bulletin will take an in-depth look at the six "economic reality" factors to be considered in making that determination.

Background

The Final Rule sets forth six factors that will be considered in determining whether a worker is an employee or an independent contractor:

- Opportunity for profit or loss depending on managerial skill.
- Investments by the worker and the potential employer.
- Degree of permanence of the work relationship.
- Nature and degree of control.
- Extent to which the work performed is an integral part of the potential employer's business.
- Skill and initiative.

Other factors may also be considered if they are relevant to the overall question of economic dependence.

The Final Rule adopts, with some changes, a proposed rule that was issued in October 2022. The DOL received 55,400 comments from employees, self-identified independent contractors, employers, trade associations, labor unions, advocacy groups, law firms, and others. This bulletin will focus on the changes that were made since the proposed rule was issued.

The language of the Final Rule with respect to the six economic reality factors is set forth below. Any content that is different from the language of the proposed rule is in blue bold. (You will note that the Final Rule refers to

the business throughout as the "potential employer" rather than the "employer.")

29 C.F.R. §795.110(b)(1) *Opportunity for profit or loss depending on managerial skill.*

This factor considers whether the worker ~~exercises managerial skill~~ has opportunities for profit or loss based on managerial skill (including initiative or business acumen or judgment) that affect~~s~~ the worker's economic success or failure in performing the work. The following facts, among others, can be relevant:

- *whether the worker determines or can meaningfully negotiate the charge or pay for the work provided;*
- *whether the worker accepts or declines jobs or chooses 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.*

If a worker has no opportunity for a profit or loss, then this factor suggests that the worker is an employee. Some decisions by a worker that can affect the amount of pay that a worker receives, such as the decision to work more hours or take more jobs when paid a fixed rate per hour or per job, generally do not reflect the exercise of managerial skill indicating independent contractor status under this factor.

(Bullets added.)

DOL explanation

- "Although the Department did not intend for the 'exercises managerial skill' language to be limiting, focusing on 'opportunities' should capture the facts relevant to a worker's profit or loss and managerial skill."
- "[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."

29 C.F.R. §795.110(b)(2) *Investments by the Worker and the Potential Employer*

This factor considers whether any investments by a worker are capital or entrepreneurial in nature. Costs to a worker of tools and equipment to perform a specific job, costs of workers' labor, and costs that the potential employer imposes unilaterally on the worker, for example, are not evidence of capital or entrepreneurial investment and indicate employee status. Investments that are capital or entrepreneurial in nature and thus indicate independent contractor status 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. Additionally, the worker's investments should be considered on a relative basis with the potential employer's investments in its overall business. The worker's investments need not be

equal to the potential employer's investments and should not be compared only in terms of the dollar values of investments or the sizes of the worker and the potential employer. Instead, the focus should be on comparing the investments to determine whether the worker is making similar types of investments as the potential employer (even if on a smaller scale) to suggest that the worker is operating independently, which would indicate independent contractor status.

DOL explanation

- "[A]n investment that is expedient to perform a particular job (such as tools or equipment purchased to perform the job and that have no broader use for the worker) does not indicate independence."
- "[C]osts unilaterally imposed by an employer on a worker are not capital or entrepreneurial in nature. Where the worker has no meaningful say either in the fact that the cost will be imposed or the amount, the cost cannot be an investment."
- "[T]he Department's modifications to the investments factor, and particularly the emphasis on comparing the worker's investments and the employer's investments qualitatively more than quantitatively, should address any concerns that a worker's failure to invest sizeable sums to offset the company's investment suggests employment status."

29 C.F.R. §795.110(b)(3) ***Degree of permanence of the work relationship.***

This factor weighs in favor of the worker being an employee when the work relationship is indefinite in duration, continuous, or exclusive of work for other employers. This factor weighs in favor of the worker being an independent contractor when the work relationship is definite in duration, non-exclusive, project-based, or sporadic based on the worker being in business for themself and marketing their services or labor to multiple entities. This may include regularly occurring fixed periods of work, although the seasonal or temporary nature of work by itself would not necessarily indicate independent contractor classification. Where a lack of permanence is due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ, ~~rather than the workers' own independent business initiative~~, this factor is not necessarily indicative of independent contractor status unless the worker is exercising their own independent business initiative.

DOL explanation

"The Department agrees that the concept of exclusivity should not be limited to work relationships that are indefinite or continuous and that it is more precise and aligned with the case law to substitute the language suggested. "

"[T]his formulation makes it clearer that the proper analysis is not categorically based on operational characteristics of particular industries, as some commenters seemed to have read into the proposal, and that it is important to consider whether the worker is exercising independent business initiative with respect to these periods of work."

29 C.F.R. §795.110(b)(4) *Nature and Degree of Control*

This factor considers the potential employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship. Facts relevant to the potential employer's control over the worker include whether the potential employer sets the worker's schedule, supervises the performance of the work, or explicitly limits the worker's ability to work for others. Additionally, facts relevant to the potential employer's control over the worker include whether the potential employer uses technological means ~~of supervision~~ to supervise the performance of the work (such as by means of a device or electronically), reserves the right to supervise or discipline workers, or places demands ~~on workers' time~~ or restrictions on workers that do not allow them to work for others or work when they choose. Whether the potential employer controls economic aspects of the working relationship should also be considered, including control over prices or rates for services and the marketing of the services or products provided by the worker. ~~Control implemented by the employer for purposes of complying with legal obligations, safety standards, or contractual or customer service standards may be indicative of control.~~ Actions taken by the potential employer for the sole purpose of complying with a specific, applicable Federal, State, Tribal, or local law or regulation are not indicative of control. Actions taken by the potential employer that go beyond compliance with a specific, applicable Federal, State, Tribal, or local law or regulation and instead serve the potential employer's own compliance methods, safety, quality control, or contractual or customer service standards may be indicative of control. More indicia of control by the potential employer favors employee status; more indicia of control by the worker favors independent contractor status.

DOL explanation

The DOL grouped its commentary into five categories: Overview of the Control Factor, Scheduling, Supervision, Setting a Price or Rate for Goods or Services, and Ability to Work for Others. The DOL's explanations in four of these categories are quoted below.

Overview of the Control Factor

- The proposed rule "shifted the focus of this factor back to the nature and degree of control exerted by the potential employer, rather than by the worker," and that did not change in the Final Rule. "Courts have consistently, and for decades, considered this factor with the focus on the potential employer, not the worker."

- Regarding the changes related to the exercise of control for compliance purposes, "the comments have persuaded the Department that the provision as proposed may lead to unintended consequences due to stakeholders' confusion and uncertainty."

Scheduling

The DOL said that the independent contractor rule issued by the Trump Administration in 2021 provided that "the worker's 'substantial control over key aspects of the performance of the work' could be demonstrated simply by 'setting his or her own schedule.'" In the view of the current DOL, this "was a too narrow framing of the law because it shifted focus away from the employer's control and did not encompass actions the employer may take that would limit the significance of the worker's ability to set their own schedule."

Supervision

Regarding the use of technology, "the Department is adding language to the control factor to clarify that the relevant consideration is not simply the employer's use of technology to supervise, but the use of technology "to supervise the performance of the work."

Ability to Work for Others

The changes to the provisions regarding ability to work for others "more accurately capture[] indirect means of limiting workers' ability to work for others."

29 C.F.R. §795.110(b)(5) *Extent to which the work performed is an integral part of the employer's business*

This factor considers whether the work performed is an integral part of the potential employer's business. This factor does not depend on whether any individual worker in particular is an integral part of the business, but rather whether the function they perform is an integral part of the business. This factor weighs in favor of the worker being an employee when the work they perform is critical, necessary, or central to the potential employer's principal business. This factor weighs in favor of the worker being an independent contractor when the work they perform is not critical, necessary, or central to the potential employer's principal business..

DOL explanation

- The one change from the proposed rule was made "to provide additional clarity."
- As contrasted with the 2021 Trump Rule, the new standard "better reflects the economic reality case law and is more consistent with the totality-of-the-circumstances approach to determining whether a worker is an employee or independent contractor . . .."

29 C.F.R. §795.110(b)(6) *Skill and initiative*

This factor considers whether the worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative. This factor indicates employee status where the worker does not use specialized skills in performing the work or where the worker is dependent on training from the potential employer to perform the work. Where the worker brings specialized skills to the work relationship, this fact is not itself indicative of independent contractor status because both employees and independent contractors may be skilled workers. It is the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an independent contractor.

DOL explanation

- The new language will "help sharpen the point that use of skills in connection with business-like initiative is what distinguishes between independent contractors and employees under this factor."
- "[C]onsistent with the analysis for this factor, and its discussion of commercial drivers' licenses

(CDLs) below, this factor would indicate independent contractor status for a worker who uses truck-driving skills in connection with business-like initiative."

- The DOL "is not intending to identify any particular occupation as lacking in specialized skills in all cases."

29 C.F.R. §795.110(b)(7) *Additional Factors*

Additional factors may be relevant in determining whether the worker is an employee or independent contractor for purposes of the FLSA, if the factors in some way indicate whether the worker is in business for themself, as opposed to being economically dependent on the potential employer for work.

DOL explanation

- The DOL made no changes to this provision, despite comments expressing concern that it could create uncertainty. In response, the DOL said that consideration of additional factors was consistent with court interpretations, the DOL's prior interpretations, and even the Trump Administration regulations.

- The DOL declined to identify any particular additional factors that might be relevant. stating "the regulatory text addressing additional factors…is sufficiently constrained to narrow the possible considerations and sufficiently flexible to capture potentially relevant factual considerations that fall outside the enumerated factors."

- The DOL agreed that certain factors are generally immaterial in determining the existence of an employment relationship, including "the place where the work is performed, the absence of a formal employment agreement, …whether an alleged independent contractor is licensed by State/local government," and "the time or mode of pay."

Current status of the Final Rule

We think the Final Rule is clearly designed to make it more difficult for businesses to successfully defend independent contractor classifications.

As previously reported, the Final Rule will take effect on March 11, provided that one of the legal challenges against it does not result in a delay of the effective date. As of the date of this bulletin, we are aware of two lawsuits seeking to stop the Final Rule from taking effect, and more are likely to be on the way:

- On January 11, a group of businesses representing dozens of industries (including gig economy corporations) filed a motion with the U.S. Court of Appeals for the Fifth Circuit, seeking to revive previous litigation involving the Biden Administration's attempt to withdraw the Trump Administration independent contractor rule in 2021. In March 2022, a federal district court in Texas reinstated the Trump rule. The DOL appealed to the Fifth Circuit, and the appellate court paused the proceedings to give the DOL the opportunity to issue a new independent contractor rule. The stay was in place while the DOL issued the proposed rule in October 2022 and the Final Rule this month. The businesses are now asking the Fifth Circuit to send their case back to the district court so that the court can address their concerns with the current Final Rule. The

case is *Coalition for Workforce Innovation v. Su*.

- On January 16, a group of freelance writers and editors represented by the Pacific Legal Foundation filed suit in a federal district court in Georgia. According to the Foundation, "The new rule is so vague and uncertain that only the DOL itself can tell if an independent contracting relationship exists. It has made this change with a wholly inadequate justification, leaving millions of contractors twisting in the wind." The case is *Warren v. U.S. Department of Labor*.

Even if the Final Rule does become effective, it remains to be seen what level of deference, if any, the courts will give to the DOL interpretations. Moreover, the federal courts do not see eye-to-eye when it comes to the proper legal analysis for determining employee versus independent contractor status.