

**DEPARTMENT OF LABOR****Wage and Hour Division****29 CFR Parts 780, 788, and 795**

RIN 1235-AA34

**Independent Contractor Status Under the Fair Labor Standards Act****AGENCY:** Wage and Hour Division, Department of Labor.**ACTION:** Notice of proposed rulemaking and request for comments.

**SUMMARY:** The U.S. Department of Labor (the Department) is revising its interpretation of independent contractor status under the Fair Labor Standards Act (FLSA or Act) in order to promote certainty for stakeholders, reduce litigation, and encourage innovation in the economy.

**DATES:** Submit written comments on or before October 26, 2020.

**ADDRESSES:** You may submit comments, identified by Regulatory Information Number (RIN) 1235-AA34, by either of the following methods: *Electronic Comments:* Submit comments through the Federal eRulemaking Portal at <http://www.regulations.gov>. Follow the instructions for submitting comments.

*Mail:* Address written submissions to Division of Regulations, Legislation, and Interpretation, Wage and Hour Division, U.S. Department of Labor, Room S-3502, 200 Constitution Avenue NW, Washington, DC 20210. *Instructions:* Please submit only one copy of your comments by only one method. Commenters submitting file attachments on [www.regulations.gov](http://www.regulations.gov) are advised that uploading text-recognized documents—i.e., documents in a native file format or documents which have undergone optical character recognition (OCR)—enable staff at the Department to more easily search and retrieve specific content included in your comment for consideration. Please be advised that comments received will become a matter of public record and will be posted without change to <http://www.regulations.gov>, including any personal information provided. All comments must be received by 11:59 p.m. on October 26, 2020 for consideration in this rulemaking. Commenters should transmit comments early to ensure timely receipt prior to the close of the comment period, as the Department continues to experience delays in the receipt of mail. Submit only one copy of your comments by only one method. *Docket:* For access to the docket to read background documents or comments, go to the

Federal eRulemaking Portal at <http://www.regulations.gov>.

**FOR FURTHER INFORMATION CONTACT:**

Amy DeBisschop, Division of Regulations, Legislation, and Interpretation, Wage and Hour Division (WHD), U.S. Department of Labor, Room S-3502, 200 Constitution Avenue NW, Washington, DC 20210; telephone: (202) 693-0406 (this is not a toll-free number). Copies of this Notice of Proposed Rulemaking (NPRM) may be obtained in alternative formats (Large Print, Braille, Audio Tape or Disc), upon request, by calling (202) 693-0675 (this is not a toll-free number). TTY/TDD callers may dial toll-free 1-877-889-5627 to obtain information or request materials in alternative formats.

Questions of interpretation and/or enforcement of the agency's regulations may be directed to the nearest WHD district office. Locate the nearest office by calling WHD's toll-free help line at (866) 4US-WAGE ((866) 487-9243) between 8 a.m. and 5 p.m. in your local time zone, or logging onto WHD's website for a nationwide listing of WHD district and area offices at <http://www.dol.gov/whd/americas2.htm>.

**SUPPLEMENTARY INFORMATION:****I. Executive Summary**

The FLSA requires covered employers to pay their nonexempt employees at least the federal minimum wage for every hour worked and overtime pay for every hour worked over 40 in a workweek, and mandates that employers keep certain records regarding their employees. A worker who performs services for an individual or entity ("person" as defined in the Act) as an independent contractor, however, is not that person's employee under the Act. Thus, the FLSA does not require such person to pay an independent contractor either the minimum wage or overtime pay, nor does it require that person to keep records regarding that independent contractor. The Act does not define the term "independent contractor," but it defines "employer" as "any person acting directly or indirectly in the interest of an employer in relation to an employee," 29 U.S.C. 203(d), "employee" as "any individual employed by an employer," *id.* at 203(e), and "employ" as "includ[ing] to suffer or permit to work," *id.* at 203(g). See also Fair Labor Standards Amendments of 1974, Public Law 93-259 (Apr. 8, 1974). Courts and the Department have long interpreted the "suffer or permit" standard to require an evaluation of the extent of the worker's economic dependence on the potential

employer—i.e., the putative employer or alleged employer—and have developed a multifactor test to analyze whether a worker is an employee or an independent contractor under the FLSA. The ultimate inquiry is whether, as a matter of economic reality, the worker is dependent on a particular individual, business, or organization for work (and is thus an employee) or is in business for him- or herself (and is thus an independent contractor). But the test's underpinning and the process for its application lack focus and have not always been sufficiently explained by courts or the Department, resulting in uncertainty among the regulated community. The Department believes that clear articulation will lead to increased precision and predictability in the economic reality test's application, which will in turn benefit workers and businesses and encourage innovation and flexibility in the economy.

Accordingly, in this Notice of Proposed Rulemaking (NPRM) the Department proposes to introduce a new part to Title 29 of the Code of Federal Regulations setting forth its interpretation of the FLSA as relevant to the question whether workers are "employees" or are independent contractors under the Act. The proposed regulations would adopt general interpretations to which courts and the Department have long adhered. For example, the proposed regulations would explain that independent contractors are workers who, as a matter of economic reality, are in business for themselves as opposed to being economically dependent on the potential employer for work. The proposed regulations would also explain that the inquiry into economic dependence is conducted through application of several factors, with no one factor being dispositive, and that actual practices are entitled to greater weight than what may be contractually or theoretically possible. The Department proposes to sharpen this inquiry into five distinct factors, instead of the five or more overlapping factors used by most courts and the Department previously. Moreover, consistent with the FLSA's text, its purpose, and the Department's experience administering and enforcing it, the Department proposes that two of those factors—the nature and degree of the worker's control over the work and the worker's opportunity for profit or loss—should be more probative of the question of economic dependence or lack thereof, and thus are afforded greater weight in the analysis than any others.

This proposed rule would be the Department's sole and authoritative

interpretation of independent contractor status under the FLSA. As such, it would replace the Department's previous interpretations of independent contractor status under the FLSA in certain contexts, including interpretations found at 29 CFR 780.330(b) (interpreting independent contractor status under the FLSA for tenants and sharecroppers) and 29 CFR 788.16(a) (interpreting independent contractor status under the FLSA for certain forestry and logging workers). The Department believes this proposal will significantly clarify to stakeholders how to distinguish between employees and independent contractors under the Act and seeks comment on all aspects of this proposed rule.

This proposed rule is expected to be an Executive Order (E.O.) 13771 deregulatory action. Details on the estimated increased efficiency and cost savings of this proposed rule can be found in the preliminary regulatory impact analysis (PRIA) provided below in section VI.

## II. Background

### A. Relevant FLSA Definitions

Enacted in 1938, the FLSA requires, among other provisions, that covered employers pay their nonexempt employees at least the federal minimum wage for every hour worked and overtime pay for every hour worked over 40 in a workweek, and mandates that employers keep certain records regarding their employees.<sup>1</sup> The FLSA does not define the term "independent contractor." The Act defines "employer" in section 3(d) to "include[] any person acting directly or indirectly in the interest of an employer in relation to an employee," "employee" in section 3(e)(1) to mean "any individual employed by an employer," and "employ" in section 3(g) to include "to suffer or permit to work."<sup>2</sup> The Supreme Court has recognized that "there is in the [FLSA] no definition that solves problems as to the limits of the employer-employee relationship under the Act." *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 728 (1947).

The Supreme Court has held that the "suffer or permit" definition is broad on its face and is more inclusive than the common law standard for determining who is employed and thereby who is an employee. The common law utilizes

traditional agency principles exclusively to examine the hiring party's right to control the manner and means by which the worker accomplishes his or her task. See *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992) ("[T]he FLSA . . . defines the verb 'employ' expansively to mean 'suffer or permit to work.' This . . . definition, whose striking breadth we have previously noted, stretches the meaning of 'employee' to cover some parties who might not qualify as such under a strict application of traditional agency law principles." (citations omitted)); *Walling v. Portland Terminal Co.*, 330 U.S. 148, 150–51 (1947) ("But in determining who are 'employees' under the Act, common law employee categories or employer-employee classifications under other statutes are not of controlling significance. This Act contains its own definitions, comprehensive enough to require its application to many persons and working relationships, which prior to this Act, were not deemed to fall within an employer-employee category." (citations omitted)); *Rutherford Food*, 331 U.S. at 728 ("The [FLSA] definition of 'employ' is broad.").

However, the Act's "statutory definition[s] . . . have [their] limits." *Tony & Susan Alamo Found. v. Sec'y of Labor*, 471 U.S. 290, 295 (1985) (internal citation omitted); see also *Portland Terminal*, 330 U.S. at 152 ("The definition 'suffer or permit to work' was obviously not intended to stamp all persons as employees."). For example, the Supreme Court recognized not long after the FLSA's passage that, despite the Act's broad definition of "employ," "[t]here may be independent contractors who take part in production or distribution who would alone be responsible for the wages and hours of their own employees." *Rutherford Food*, 331 U.S. at 729. Accordingly, federal courts of appeals have uniformly held, and the Department has consistently maintained, that independent contractors are not "employees" for purposes of the FLSA. See, e.g., *Saleem v. Corporate Transp. Group, Ltd.*, 854 F.3d 131, 139–40 (2d Cir. 2017) (noting that independent contractors are separate from employees in the context of the FLSA); *Karlson v. Action Process Serv. & Private Investigation, LLC*, 860 F.3d 1089, 1092 (8th Cir. 2017) ("FLSA wage and hour requirements do not apply to true independent contractors."); *Scantland v. Jeffry Knight, Inc.*, 721 F.3d 1308, 1311 (11th Cir. 2013) ("[The Act's] 'broad' definitions do not, however, bring 'independent contractors' within the

FLSA's ambit."); *Hopkins v. Cornerstone America*, 545 F.3d 338, 342 (5th Cir. 2008) (observing that the "FLSA applies to employees but not to independent contractors").

Accordingly, the FLSA does not require any "person" to pay an independent contractor the minimum wage or overtime pay under sections 6(a) and 7(a) or to keep records regarding that independent contractor under section 11(c).

### B. Economic Dependence and the Economic Reality Test

#### 1. Supreme Court Development of the Economic Reality Test

In a series of cases from 1944 to 1947, the U.S. Supreme Court explored the limits of the employer-employee relationship under three different federal statutes: The FLSA, the National Labor Relations Act (NLRA), and the Social Security Act (SSA).

In the first of those cases, *NLRB v. Hearst Publications, Inc.*, 322 U.S. 111 (1944), the Court considered the meaning of "employee" under the NLRA, which merely defined the term to "include any employee." *Id.* at 118–20. The Court explained that the meaning of employee "takes color from its surroundings . . . [in] the statute where it appears, and derives meaning from the context of that statute, which must be read in the light of the mischief to be corrected and the end to be attained." *Id.* at 124 (citations omitted). The *Hearst* Court rejected application of the common law standard alone, see *id.* at 123–25, and concluded that "the broad language of the [NLRA's] definitions . . . leaves no doubt that its applicability is to be determined broadly, in doubtful situations, by underlying economic facts rather than technically and exclusively by previously established legal classifications." *Id.* at 129. Congress's reaction to *Hearst's* interpretation of "employee" under the NLRA "was adverse," and on June 23, 1947, Congress amended the NLRA "with the obvious purpose of hav[ing] the Board and the courts apply general agency principles in distinguishing between employees and independent contractors under the [NLRA]." *NLRB v. United Ins. Co. of Am.*, 390 U.S. 254, 256 (1968).

On June 16, 1947, one week before Congress amended the NLRA to abrogate *Hearst*, the Supreme Court decided *United States v. Silk*, 331 U.S. 704 (1947), which addressed the distinction between employees and independent contractors under the SSA. In that case, the Court favorably summarized *Hearst* as setting forth

<sup>1</sup> See 29 U.S.C. 206(a), 207(a) (minimum wage and overtime pay requirements); 29 U.S.C. 211(c) (recordkeeping requirements).

<sup>2</sup> 29 U.S.C. 203(d), (e), (g). The Act defines a "person" as "an individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons." 29 U.S.C. 203(a).

“economic reality,” as opposed to “technical concepts” of the common law standard alone, as the framework for determining workers’ classification. *Id.* at 712–14. But it also acknowledged that not “all who render service to an industry are employees.” *Id.* Although the Court found it to be “quite impossible to extract from the [SSA] a rule of thumb to define the limits of the employer-employee relationship,” the Court identified five factors as “important for decision”: “degrees of control, opportunities for profit or loss, investment in facilities, permanency of relation[,] and skill required in the claimed independent operation.” *Id.* at 716. The Court added that “[n]o one [factor] is controlling nor is the list complete.” *Id.* Just a week after *Silk*, on June 23, 1947, the Court reiterated these five factors in another case involving employee or independent contractor status under the SSA. *See Bartels v. Birmingham*, 332 U.S. 126, 130 (1947). The Court explained that, under the SSA, employee status “was not to be determined solely by the idea of control which an alleged employer may or could exercise over the details of the service rendered to his business by the worker.” *Id.* Although “control is characteristically associated with the employer-employee relationship,” employees under “social legislation” such as the SSA are “those who as a matter of economic reality are dependent upon the business to which they render service.” *Id.* Thus, in addition to control, “permanency of the relation, the skill required, the investment in the facilities for work[,] and opportunities for profit or loss from the activities were also factors” to consider. *Id.* Although the Court identified these specific factors as relevant to the analysis, it explained that “[i]t is the total situation that controls” the worker’s classification under the SSA. *Id.*

Decided the same day as *Silk*, *Rutherford Food* applied *Hearst’s* and *Silk’s* reasoning to the FLSA. *Rutherford Food* addressed whether certain workers at a plant owned by Kaiser Packing Company (Kaiser) who cut meat from the bones of slaughtered cattle were Kaiser’s employees under the FLSA or were instead independent contractors. Noting that “[d]ecisions that define the coverage of the employer-employee relationship under the [NLRA and the SSA] are persuasive in the consideration of a similar coverage under the [FLSA],” 331 U.S. at 723–24 (citing *Hearst* and *Silk*), the Court seemed to follow the path laid down in these previous cases by examining facts pertaining to the five

factors identified in *Silk*. For example, the Court noted that the slaughterhouse workers performed unskilled work “on the production line.” *Id.* at 730. “The premises and equipment of Kaiser were used for the work,” indicating little investment by the workers. *Id.* “The group had no business organization that could or did shift as a unit from one slaughterhouse to another,” indicating a permanent work arrangement. *Id.* “The managing official of the plant kept close touch on the operation,” indicating control by the alleged employer. *Id.* And “[w]hile profits to the boners depended upon the efficiency of their work, it was more like piecework than an enterprise that actually depended for success upon the initiative, judgment or foresight of the typical independent contractor.” *Id.*

In addition to facts relevant to the five *Silk* factors, the Court also considered whether the work was “a part of the integrated unit of production” (meaning whether the putative independent contractors were integrated into the assembly line alongside the company’s employees) to assess whether they were employees or independent contractors under the FLSA. *Id.* at 729–730. Ultimately, the Court agreed with the appellate court that the “underlying economic realities” led to the conclusion that the boners were employees of Kaiser under the FLSA. *See id.* at 727.

In November 1947, five months after *Silk* and *Rutherford Food*, the Department of Treasury (Treasury) proposed regulations governing the determination of whether an individual is an independent contractor or employee under the SSA, which used a test that balanced the following factors:

1. Degree of control of the individual;
2. Permanency of relation;
3. Integration of the individual’s work in the business to which he renders service;
4. Skill required by the individual;
5. Investment by the individual in facilities for work; and
6. Opportunity of the individual for profit or loss.

12 FR 7966. Factors 1, 2, and 4–6 corresponded directly with the five factors identified as being “important for decision” in *Silk*, 331 U.S. at 716, and the third factor corresponded with *Rutherford Food’s* consideration of the fact that the workers were “part of an integrated unit of production.” 331 U.S. at 729. The Treasury proposal further relied on *Bartels*, 332 U.S. at 130, to apply these factors to determine whether a worker was “dependent as a matter of economic reality upon the business to which he renders services.” 12 FR 7966.

However, in 1948, Congress promptly rejected this application of the proposed test. A committee report described the test as “‘a dimensionless and amorphous abstraction’” that would confer upon “‘the administrative agencies and the courts an unbridled license to say, at will, whether an individual is an employee or an independent contractor’” for purposes of the SSA. *United States v. W.M. Webb, Inc.*, 397 U.S. 179, 187–88 (1970) (quoting S. Rep. No. 1255, at 12 (1948) and H.R. Rep. No. 2168, at 9 (1948)). The report stated that Congress amended the SSA to “avoid[] the uncertainty of the proposed ‘economic reality’ test” and to ensure that the common law control definition of employee alone would apply to that statute. *See id.* at 183–86, 191; 42 U.S.C. 410(j) (“The term ‘employee’ [under the SSA] means . . . any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.”).

Congress abrogated the interpretations of the definitions of “employee” adopted in *Hearst* for the NLRA and in *Silk* and *Bartels* for the SSA “to demonstrate that the usual common-law principles were the keys to meaning.” *Darden*, 503 U.S. at 324–25. However, Congress did not similarly amend the FLSA. Thus, the Supreme Court stated in *Darden* that the scope of employment under the FLSA is broader than that under common law and is determined by the economic reality of the relationship at issue, relying on the “suffer or permit” standard that is unique to the FLSA. *See id.* However, since implicitly doing so in *Rutherford Food*, the Court has not again applied (or rejected the application of) the *Silk* factors to an FLSA classification question. Accordingly, the Supreme Court has not mandated any specific set or formulation of economic reality factors for purposes of the FLSA, nor has it explicitly opined on any factor’s relative probative value to the inquiry. *See Goldberg v. Whitaker House Co-op., Inc.*, 366 U.S. 28, 33 (1961) (noting that “‘economic reality’ rather than ‘technical concepts’ is . . . the test of employment” under the FLSA (citing *Silk*, 331 U.S. at 713; *Rutherford Food*, 331 U.S. at 729)); *Tony & Susan Alamo*, 471 U.S. at 301 (“The test of employment under the Act is one of ‘economic reality.’” (quoting *Whitaker House*, 366 U.S. at 33)).<sup>3</sup>

<sup>3</sup> In *Whitaker House*, the Supreme Court concluded that certain homeworkers were employees under the FLSA, as opposed to being “self-employed” or “independent.” 366 U.S. at 33.

## 2. Application of the Economic Reality Test by Federal Courts of Appeals

Following *Rutherford Food*, federal courts of appeals have also stated that the common law standard alone does not determine employee or independent contractor status under the FLSA and that instead the inquiry was one of economic reality. *See, e.g., Wirtz v. Dr. Pepper Bottling Co. of Atlanta*, 374 F.2d 5, 8 (5th Cir. 1967) (“[C]ommon law concepts of the employer-employee relationship are not controlling.”); *McComb v. Homeworkers’ Handicraft Coop.*, 176 F.2d 633, 636 (4th Cir. 1949) (same). For several decades after *Rutherford Food*, courts applied this reasoning to ask, for example, whether a worker took “the usual path of an employee,” *Dr. Pepper*, 347 F.2d at 8, or had characteristics that “resembled . . . the typical independent contractor,” *Schultz v. Cadillac Assocs., Inc.*, 413 F.2d 1215, 1217 (7th Cir. 1969). But they did not adopt a systematic approach to the question.

In the 1970s and 1980s, federal courts of appeals began to adopt a multifactor “economic reality” test based on *Silk*, *Rutherford Food*, and *Bartels* similar to Treasury’s 1947 proposed SSA regulation to analyze whether a worker was an employee or an independent contractor under the FLSA.<sup>4</sup>

Drawing on the Supreme Court precedent discussed above, courts have recognized that the heart of the inquiry is whether “as a matter of economic reality” the workers are “dependent upon the business to which they render service.” *Usery v. Pilgrim Equip. Co.*, 527 F.2d 1308, 1311 (5th Cir. 1976) (quoting *Bartels*, 332 U.S. at 130 (emphasis added)). And some courts have clarified that this question of economic dependence may be boiled down to asking “whether the individual is or is not, as a matter of economic fact, in business for himself.” *Donovan v. Tehco, Inc.*, 642 F.2d 141, 143 (5th Cir. 1981); *see also Parrish v. Premier Directional Drilling, L.P.*, 917 F.3d 369, 380 (5th Cir. 2019) (“Essentially, our task is to determine whether the individual is, as a matter of economic reality, in business for himself.” (internal quotation marks and citation

omitted)); *Saleem*, 854 F.3d at 139 (“[O]ur ultimate concern [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.” (internal quotation marks and citations omitted)); *Baker v. Flint Eng’g & Constr. Co.*, 137 F.3d 1436, 1443 (10th Cir. 1998) (“Our final step is to review the findings on each of the above factors and determine whether plaintiffs, as a matter of economic fact, depend upon [the employer’s] business for the opportunity to render service, or are in business for themselves.”). Courts have emphasized that the inquiry into the level and nature of dependence in a given relationship should be based on the totality of the circumstances. *See, e.g., Donovan v. DialAmerica Mktg., Inc.*, 757 F.2d 1376, 1382 (3d Cir. 1985) (noting that *Rutherford Food* “emphasized that the circumstances of the whole activity should be considered . . .”). But these courts have also explained that a non-exhaustive, standard set of factors—derived from *Silk* and *Rutherford Food*—shape and guide this inquiry. *See, e.g., Usery*, 527 F.2d at 1311 (identifying “[f]ive considerations [which] have been set out as aids to making the determination of dependence, vel non”); *Real v. Driscoll Strawberry Assocs., Inc.*, 603 F.2d 748, 754 (9th Cir. 1979) (articulating a six-factor test).

In *Driscoll*, the Ninth Circuit Court of Appeals described its six-factor test as follows:

1. The degree of the alleged employer’s right to control the manner in which the work is to be performed;
2. the alleged employee’s opportunity for profit or loss depending on his managerial skill;
3. the alleged employee’s investment in equipment or materials required for his task, or his employment of helpers;
4. whether the service rendered requires a special skill;
5. the degree of permanency of the working relationship; and
6. whether the service rendered is an integral part of the alleged employer’s business.

*Id.* at 754. Most courts of appeals articulate a similar test, but application between courts may vary significantly. *See, e.g., Sec’y of Labor v. Lauritzen*, 835 F.2d 1529, 1534–35 (7th Cir. 1987); *DialAmerica Mktg.*, 757 F.2d at 1382; *Donovan v. Brandel*, 736 F.2d 1114, 1117 (6th Cir. 1984). For example, the Second Circuit has analyzed opportunity for profit or loss and investment (the second and third factors listed above) together as one factor. *See, e.g., Brock v. Superior Care, Inc.*, 840

F.2d 1054, 1058 (2d Cir. 1988). And the Fifth Circuit has not adopted the sixth factor listed above, which analyzes the integrality of the work. *See, e.g., Usery*, 527 F.2d at 1311.

A few courts of appeals have adopted noteworthy modifications to the economic reality factors as originally articulated in 1947 by the Supreme Court and by the Treasury Department. *Compare, e.g., DialAmerica Mktg.*, 757 F.2d at 1382, with *Silk*, 331 U.S. at 716, and 12 FR 7966. First, the “skill required” factor identified in *Silk*, 331 U.S. at 716, is now articulated more expansively by some courts of appeals as including consideration of “initiative.” *See, e.g., Parrish*, 917 F.3d at 379 (“the skill and initiative required in performing the job”); *Karlson*, 860 F.3d at 1093 (same); *Superior Care*, 840 F.2d at 1058–59 (“the degree of skill and independent initiative required to perform the work”). Second, *Silk* analyzed workers’ investments, 331 U.S. at 717–19, and the investment factor was articulated in the proposed 1947 Treasury regulation as evaluating “investments by the individual in facilities for work.” 12 FR 7966 (emphasis added). However, the Fifth Circuit Court of Appeals has modified the “investment” factor to consider “the extent of the relative investments of the worker and the alleged employer.” *Hopkins*, 545 F.3d at 343. Some other circuits have adopted this “relative investment” approach but continue to use the phrase “worker’s investment” to describe the factor. *See, e.g., Keller v. Miri Microsystems LLC*, 781 F.3d 799, 810 (6th Cir. 2015); *Dole v. Snell*, 875 F.2d 802, 805 (10th Cir. 1989).

Third, although the permanence factor under *Silk* was understood in the 1947 Treasury proposal to mean the continuity and duration of working relationships, *see* 12 FR 7967, some courts of appeals have expanded this factor to also consider the exclusivity of such relationships. *See, e.g., Scantland*, 721 F.3d at 1319; *Keller*, 781 F.3d at 807. Finally, *Rutherford Food*’s consideration of whether work is “part of an integrated unit of production,” 331 U.S. at 729—which was articulated as “integration of the individual’s work” in the 1947 Treasury proposal, 12 FR 7966—is now typically articulated by many courts of appeal as whether the service rendered is “integral,” which those courts have mistakenly applied as meaning important or central to the potential employer’s business. *See, e.g., Verma v. 3001 Castor, Inc.*, 937 F.3d 221, 229 (3rd Cir. 2019) (concluding that workers’ services were integral because they were the providers of the business’s “primary offering”); *Acosta*

<sup>4</sup> The Court’s analysis did not explicitly mention the *Silk* factors or the concept of economic dependence from *Bartels*. However, the Court focused on the fact that workers were not “selling their products on the market for whatever price they could command,” but were instead “regimented under one organization, manufacturing what the organization desire[d] and receiving the compensation the organization dictates.” *Id.*

<sup>4</sup> As explained below, this multifactor economic reality test had also been enforced and articulated by the Department in subregulatory guidance since the 1950s.

*v. Off Duty Police Servs., Inc.*, 915 F.3d 1050, 1055 (6th Cir. 2019) (concluding that services provided by workers were “integral” because the putative employer “built its business around” those services); *McFeeley*, 825 F.3d at 244 (consideration “the importance of the services rendered to the company’s business”); *DialAmerica*, 757 F.2d at 1385 (“[W]orkers are more likely to be ‘employees’ under the FLSA if they perform the primary work of the alleged employer.”).

Courts of appeals applying the multifactor economic reality test draw from the totality of circumstances, with no single factor being determinative by itself. *See, e.g., Keller*, 781 F.3d at 807 (“No one factor is determinative.”); *Baker*, 137 F.3d at 1440 (“None of the factors alone is dispositive; instead, the court must employ a totality-of-the-circumstances approach.”); *Martin v. Selker Bros.*, 949 F.2d 1286, 1293 (3rd Cir. 1991) (“It is a well-established principle that the determination of the employment relationship does not depend on isolated factors . . . neither the presence nor the absence of any particular factor is dispositive.”).

### 3. Application of the Economic Reality Test by WHD

Since at least 1954, WHD has applied a multifactor analysis when considering whether a worker is an employee under the FLSA or is instead an independent contractor. *See* WHD Opinion Letter (Aug. 13, 1954) (applying six factors very similar to the six economic reality factors currently used by courts of appeal and noting that “the determination depends on the circumstances of the whole activity considered in light of the statutory purposes of the Act” (internal quotation marks omitted)). In 1956, WHD reiterated the six factors and noted that “[t]he degree of control retained by the principal has [been] rejected as the sole criterion to be applied.” WHD Opinion Letter (Feb. 8, 1956). In 1964, WHD stated: “The Supreme Court has made it clear that an employee, as distinguished from a person who is engaged in a business of his own, is one who as a matter of economic reality follows the usual path of an employee and is dependent on the business which he serves.” WHD Opinion Letter FLSA–795 (Sept. 30, 1964).

Over the years since, WHD has issued numerous opinion letters addressing whether a worker is an employee under the FLSA or an independent contractor. In those letters, WHD has generally relied on a multifactor analysis very similar to the six economic reality factors identified above; the

circumstances of the whole activity are considered; the inquiry is broader than the common law control standard alone; and a worker is an employee if, as a matter of economic reality, he or she is economically dependent on the employer as opposed to in business for him- or herself.<sup>5</sup> WHD has also promulgated regulations applying a multifactor analysis for independent contractor status under the FLSA in certain specific industries. *See, e.g.,* 29 CFR 780.330(b) (applying a six factor economic reality test to determine whether a sharecropper or tenant is an independent contractor or employee under the Act); 29 CFR 788.16(a) (applying a six factor economic reality test in forestry and logging operations with no more than eight employees). And WHD has promulgated a regulation applying a multifactor economic reality analysis for determining independent contractor status under the Migrant and Seasonal Agricultural Worker Protection Act (MSPA). The MSPA regulation is based on the FLSA’s definition of “employ” because MSPA incorporates that definition, and it asks “whether or not an *independent contractor* or *employment* relationship exist under the Fair Labor Standards Act.” 29 CFR 500.20(h)(4) (emphasis in original).

WHD Fact Sheet #13, “Employment Relationship under the Fair Labor Standards Act (FLSA)” (Jul. 2008), similarly states that, when determining whether an employment relationship exists under the FLSA: The common law control is not the exclusive consideration; instead, “it is the total activity or situation which controls”; and “an employee, as distinguished from a person who is engaged in a business of his or her own, is one who, as a matter of economic reality, follows the usual path of an employee and is dependent on the business which he or she serves.”<sup>6</sup> The Fact Sheet identifies seven economic reality factors; in addition to factors that are similar to the six factors identified above, it also

considers the worker’s “degree of independent business organization and operation.”<sup>7</sup>

WHD’s most recent opinion letter addressing this issue, from 2019, generally applied the principles and factors similar to those described in the prior opinion letters and Fact Sheet #13, but not the “business organization” factor (which it said was “[e]ncompassed within” the other factors). The opinion letter addressed the FLSA classification of service providers who used a virtual marketplace company to be referred to end-market consumers to whom the services were actually provided. WHD concluded that the service providers appeared to be independent contractors and not employees of the virtual marketplace company. *See* WHD Opinion Letter FLSA2019–6 at 7. WHD found that it was “inherently difficult to conceptualize the service providers’ ‘working relationship’ with [the virtual marketplace company], because as a matter of economic reality, they are working for the consumer, not [the company].” *Id.* Because “[t]he facts . . . demonstrate economic independence, rather than economic dependence, in the working relationship between [the virtual marketplace company] and its service providers,” WHD opined that they were not employees of the company under the FLSA but rather were independent contractors. *Id.* at 9.

As explained in greater detail below, these prior interpretations of independent contractor status, which themselves have evolved over time, are subject to the same limitations as the court opinions from the same period, and the Department believes that stakeholders would benefit from clarification. As such, the Department is proposing to promulgate a clearer and more consistent standard for evaluating whether a worker is an employee or independent contractor under the FLSA.

### III. Need for Rulemaking

The Department has never promulgated a generally applicable regulation addressing the question of who is an independent contractor and, thus, not an employee under the Act. Instead, as described above, the Department has issued and revised subregulatory guidance since at least

<sup>5</sup> *See, e.g.,* WHD Opinion Letter FLSA2019–6 at 4 (Apr. 29, 2019); WHD Opinion Letter, 2002 WL 32406602, at \*2 (Sept. 5, 2002); WHD Opinion Letter, 2000 WL 34444342, at \*3 (Dec. 7, 2000); WHD Opinion Letter, 2000 WL 34444352, at \*1 (Jul. 5, 2000); WHD Opinion Letter, 1999 WL 1788137, at \*1 (Jul. 12, 1999); WHD Opinion Letter, 1995 WL 1032489, at \*1 (June 5, 1995); WHD Opinion Letter, 1995 WL 1032469, at \*1 (Mar. 2, 1995); WHD Opinion Letter, 1986 WL 740454, at \*1 (June 23, 1986); WHD Opinion Letter, 1986 WL 1171083, at \*1 (Jan. 14, 1986); WHD Opinion Letter WH–476, 1978 WL 51437, at \*2 (Oct. 19, 1978); WHD Opinion Letter WH–361, 1975 WL 40984, at \*1 (Oct. 1, 1975); WHD Opinion Letter (Sept. 12, 1969); WHD Opinion Letter (Oct. 12, 1965).

<sup>6</sup> Fact Sheet #13 is available at <https://www.dol.gov/sites/dolgov/files/WHD/legacy/files/whdfs13.pdf>.

<sup>7</sup> On July 15, 2015, WHD issued Administrator’s Interpretation No. 2015–1, “The Application of the Fair Labor Standards Act’s ‘Suffer or Permit’ Standard in the Identification of Employees Who Are Misclassified as Independent Contractors” (AI). The AI provided guidance regarding the employment relationship under the FLSA and the application of the six economic realities factors. The AI was withdrawn on June 7, 2017 and is no longer in effect.

1954, using different variations of a multifactor economic reality test that analyzes economic dependence to distinguish independent contractors from employees. The Department has also applied the multifactor test in regulations addressing the meaning of independent contractor in specific industries. *See, e.g.*, 29 CFR 780.330(b); 29 CFR 788.16(a); 29 CFR 500.20(h)(4). For reasons explained below, however, that multifactor test, as currently applied, has proven to be unclear and unwieldy. The Department thus proposes to promulgate a regulation that explains the contours of the economic reality test and clarifies and sharpens a test that has become less clear and consistent through decades of case-by-case administration in the courts of appeals. If this proposed rule were finalized, it would contain the Department's sole and authoritative interpretation of independent contractor status under the FLSA. As such, the Department is proposing to strike previous industry-specific interpretations set forth in 29 CFR 780.330(b) and 788.16(a) and replace them with cross-references to the interpretation set forth in this proposed rule. The Department considered making similar revisions to its regulation addressing independent contractor status under the MSPA in 29 CFR 500.20(h)(4), but is not proposing not to make such revisions at this time, as explained further below. The Department invites comments on the need for conforming edits to these or similar provisions.

#### A. Challenges Presented by the Economic Reality Test and Its Application

The economic reality test has been criticized on several fronts. First, the test's overarching concept of "economic dependence" is under-developed and sometimes inconsistently applied, rendering it a source of confusion. Second, the test is indefinite and amorphous in that it makes all facts potentially relevant without providing any guidance on how to prioritize or balance different and sometimes competing considerations. Third, inefficiency and lack of structure in the test further stem from blurred boundaries between the factors. Fourth, these shortcomings have become more apparent over time as technology, economic conditions, and work relationships have evolved.

#### 1. Confusion Regarding the Meaning of Economic Dependence

Courts and the Department agree that economic dependence is the touchstone

of the economic reality test. *See, e.g., Parrish*, 917 F.3d at 380; *McFeeley*, 825 F.3d at 241; *see also Bartels*, 332 U.S. at 130 (noting that the inquiry is whether "as a matter of economic reality," the worker is "dependent upon the business to which [he or she] render[s] service"). But underdeveloped analysis and inconsistency cloud the application of this touchstone, generating uncertainty both in and outside of litigation. Given the central importance of the economic dependence concept, any confusion on this front is problematic. The 1948 Senate Report criticized Treasury's proposal to rely on economic dependence for determining independent contractor status under the SSA by rhetorically asking: "Who, in this whole world engaged in any sort of service relationship, is not dependent as a matter of economic reality on some other person? The corner grocer, clearly not an employee, is economically dependent upon his customers, his banker, his supplier." S. Rep. No. 80–1255 at 12 (1948). In other words, "economic dependency is a vague concept that without further explanation and refinement is often difficult, if not impossible, to apply."<sup>8</sup>

The Department and some courts have attempted to provide a measure of clarity by explaining, for example, that the proper inquiry is "whether the workers are dependent on a particular business or organization for their continued employment" in that line of business," *Mr. W. Fireworks*, 814 F.2d at 1054 (emphasis in original) (quoting *DialAmerica*, 757 F.2d at 1385), or instead "are in business for themselves," *Saleem*, 854 F.3d at 139. But the Department and many courts have often applied the test without helpful clarification on the meaning of the economic dependency that they are seeking.<sup>9</sup>

The lack of explanation of economic dependence has sometimes led to inconsistent approaches and results. For example, the Fifth Circuit held in 2009 that cable splicers hired as putative independent contractors by BellSouth to provide post-Hurricane Katrina repairs along the Gulf Coast were actually employees. *See Cromwell v. Driftwood Elec. Contractor, Inc.*, 348 F. App'x 57 (5th Cir. 2009). That case applied the same approach to economic dependence as *Mr. W. Fireworks* and similar cases, asking whether "the worker is economically dependent upon the

alleged employer or is instead in business for himself." *Id.* at 59. Less than a year later, a different panel of that same circuit applied a second approach to economic dependence to find another cable splicer hired under a very similar arrangement by the same company to be an independent contractor. *See Thibault v. BellSouth Telecommunication*, 612 F.3d 843 (5th Cir. 2010).<sup>10</sup> The *Thibault* court distinguished the result in *Cromwell* in part by highlighting the plaintiff's sources of income and wealth other than from BellSouth in the analysis of economic dependence. *Id.* at 849.<sup>11</sup> *Thibault's* reliance on income and wealth sources to analyze economic dependence is incompatible with *Mr. W. Fireworks* and similar decisions, which have repeatedly explained that "[e]conomic dependence is not conditioned on reliance on an alleged employer for one's primary source of income, for the necessities of life." 814 F.2d at 1054 (emphasis in original).<sup>12</sup>

The Department agrees with *Mr. W. Fireworks* and similar courts that "the proper test of economic dependence . . . examines whether the workers are dependent on a particular business or organization for their continued employment." *Id.* (quoting *DialAmerica*, 757 F.2d at 1385); *see also Halferty*, 821 F.2d at 268 ("[I]t is not dependence in the sense that one could not survive without the income from the job that we examine, but dependence for continued employment."). Dependence for work as opposed to income comports with the FLSA's "suffer or permit" standard for employment relationship. 29 U.S.C. 203(g). An individual who depends on a potential employer for work is an employee whom the

<sup>10</sup> In both cases, the splicers performed post-Hurricane Katrina repairs for BellSouth along the Gulf Coast; provided their own tools and trucks; received assignments in the same manner; received neither training nor close supervision; and worked the same 12-hour shifts for 13 days at a time. Compare *Cromwell*, 348 F. App'x at 58–59, with *Thibault*, 612 F.3d at 844–49.

<sup>11</sup> Specifically, Mr. Thibault earned significant profits from his own sales company, "owned eight drag-race cars [that] generated \$1,478 in income from racing professionally[.]" and managed "commercial rental property that generated some income." *Thibault*, 612 F.3d at 849. The *Thibault* court also highlighted the fact that Mr. Thibault worked for only three months—although he intended to work for seven or eight months—before being fired. *Id.* at 846, 849. In contrast, the splicers in *Cromwell* worked approximately eleventh months. 348 F. App'x at 58.

<sup>12</sup> *See also Off Duty Police*, 915 F.3d at 1058 ("[W]hether a worker has more than one source of income says little about that worker's employment status."); *DialAmerica*, 757 F.2d at 1385 ("The economic-dependence aspect of the [economic reality] test does not concern whether the workers at issue depend on the money they earn for obtaining the necessities of life.").

<sup>8</sup> Bruce Goldstein, et al., *Enforcing Fair Labor Standards in the Modern American Sweatshop: Rediscovering the Statutory Definition of Employment*, 46 UCLA L. Rev. 983, 1009 (1999) (collecting cases).

<sup>9</sup> *Id.* at 1010.

employer suffers or permits to work. In contrast, an independent contractor does not work at the sufferance or permission of an employer because, as a matter of economic reality, he or she is in business for him- or herself. See *Saleem*, 854 F.3d at 139.

Without a consistent understanding of economic dependence, the multifactor balancing test is left without a meaningful anchor. As a result, the test's factors may become "an end in themselves" instead of, as they are intended to be, guideposts in the inquiry of economic dependence or lack thereof.<sup>13</sup> For example, in *Parrish*, 917 F.3d 369, the Fifth Circuit appears to have applied three different concepts of economic dependence in a single opinion to analyze the control, opportunity for profit or loss, and investment factors. First, the court analyzed the control factor through the same concept of dependence as *Mr. W Fireworks*, announcing that "our task is to determine whether the individual is, as a matter of economic reality, in business for himself." *Parrish*, 917 F.3d at 379. The *Parrish* court reasoned that mandated "safety training and drug testing, when working at an oil-drilling site, is not the type of control that counsels in favor of employee status." *Id.* at 382 (emphasis in original). This analysis is consistent with the "in business for himself" approach because an oil-drilling company reasonably would require safety and drug testing of both employees (who depend on the company for work) and independent contractors (who are in business for themselves), since an accident could pose potentially significant risks to the worksite and to workers, regardless whether caused by an employee or an independent contractor.

The *Parrish* court then expressly departed from *Mr. W Fireworks* in favor of *Thibault's* dependence-for-income approach to analyze the opportunity for profit or loss factor. *Id.* at 384. Specifically, the court held that the consultant was an independent contractor, in part, because he also earned income from his own goat farm. See *id.* at 383 ("Thibault is more on point [than *Mr. W Fireworks*]. Accordingly we consider . . . plaintiffs' enterprises, such as the goat farm, as a part of the overall analysis of how dependent plaintiffs were on [defendant]."). But the goat farm has absolutely nothing to do with whether the worker was in business for himself as a consultant or was "dependent on a particular business or organization for [his] continued employment in that line

of business." *Mr. W Fireworks*, 814 F.2d at 1054. Put another way, the economic reality analysis should ask whether the plaintiff had "opportunity for profit or loss . . . in the claimed independent operations," *Silk*, 331 U.S. at 716, which in *Parrish* was consulting, not goat farming.

The *Parrish* court impliedly took yet a third approach to economic dependence when it analyzed the investment factor by comparing the dollar value of "each worker's individual investment" to the investment made by an oil drilling company in its overall operations: "Obviously, [the drilling company] invested more money at a drill site compared to each plaintiff's investments." *Id.* at 383 (emphasis in original). That comparison was unresponsive to the economic dependence inquiry of whether the worker is "[e]ssentially . . . in business for himself," *id.* at 379, because large companies routinely contract for services with smaller entrepreneurs. Instead, the worker's investment (or lack thereof) should have been analyzed to determine whether the worker had an independent operation, distinct from the potential employer's business, which created an opportunity for profit or loss.

The 1948 Senate Report cautioned that economic dependence was potentially "dimensionless." And although courts and the Department have since added some guidance, the concept may be inconsistently applied and under-analyzed. A more developed and dependable touchstone at the heart of the economic reality test is needed to guide the regulated community. Under this proposal, the Department would interpret and apply "economic dependence" consistent with the foregoing discussion.

## 2. The Lack of Focus in the Multifactor Balancing Test

Under the test, the Department and courts analyze the totality of circumstances making up the economic reality of the relationship to determine a worker's classification. But, as Judge Easterbrook warned in 1987, "'reality' encompasses millions of facts, and unless we have a legal rule with which to sift the material from the immaterial, we might as well examine the facts through a kaleidoscope." *Lauritzen*, 835 F.2d at 1539 (Easterbrook J., concurring) ("[A]ny balancing test begs questions about which aspects of 'economic reality' matter, and why."). Indeed, Congress rejected Treasury's 1947 proposal to use the multifactor balancing test under the SSA, with some

senators expressing concern that, "on virtually no state of facts may anyone be certain whether or not he has a tax liability." *Webb*, 397 U.S. at 188 (quoting S. Rep. No. 1255, at 12 (1948)). The same uncertainty often exists under the FLSA. So far, neither the Department nor courts have articulated clear, generally applicable guidance about how the multiple factors, and the countless facts encompassed therein, are to be balanced, creating uncertainty for the regulated community when, as is often the case, the significance of facts is unclear or factors point in opposite directions.

Courts applying the economic reality test often analyze the factors individually and then reach an overall decision about a worker's classification without meaningful explanation of how they balanced the factors to reach the final decision. See, e.g., *Parrish*, 917 F.3d at 380 (analyzing each factor separately and then explaining "for the reasons stated *supra*, we reach the same conclusions as did the district court"); *Chao v. Mid-Atl. Installation Servs., Inc.*, 16 F. App'x 104, 108 (4th Cir. 2001) (same); *Snell*, 875 F.2d at 912 (same). This is so even where many facts and factors support both sides of the classification inquiry. See, e.g., *Acosta v. Paragon Contractors Corp.*, 884 F.3d 1225, 1238 (10th Cir. 2018) (concluding, without explanation as to weighing of the factors, that workers were employees where two factors (control and integral part) favored independent contractor status and four factors (opportunity for profit or loss, investment, skill, and permanence) favored employee status); *Iontchev v. AAA Cab. Services*, 685 F. App'x 548, 550 (9th Cir. 2017) (concluding, without explanation as to weighing of the factors, that the workers were independent contractors where two factors (control and opportunity for profit or loss) favored independent contractor status; one factor (investment) was neutral; and three factors (skill, permanence, and integral part) favored employee status).

At other times, courts have provided analysis as to the relative weight of the factors in the specific case before them. For example, some courts have noted where factors weigh "strongly" or "weakly." See, e.g., *Scantland*, 721 F.3d at 1313–19 (finding that, assuming factual inferences in favor of the workers, the control, opportunity for profit or loss, permanence, and integral part factors strongly point to employee status, and the investment and skill factors weakly favor independent contractor status); *Superior Care*, 840 F.2d at 1059 (finding that opportunity

<sup>13</sup> Goldstein, *supra* note 8 at 1010.



for profit or loss and integral part factors “both weigh heavily in favor of the . . . conclusion that nurses are employees,” while skill and permanence factors “weigh slightly in favor of independent status, [but] do not tip the balance”). And at least one court recently dispensed with a factor-by-factor analysis and instead focused its analysis on only those facts that determined the outcome in the case. *See Saleem*, 854 F.3d at 140 (“draw[ing] upon and discuss[ing] the *Silk* factors where relevant” to the economic reality of the relationship at issue).

While identifying the most relevant factors in a specific case lends more clarity than a siloed analysis of each factor devoid of context, this approach still leaves the regulated community without generally applicable guidance as to what matters most and why. *See Lauritzen*, 835 F.2d at 1539 (Easterbrook J., concurring) (“A legal approach calling on judges to examine all of the facts, and balance them, avoids formulating a rule of decision . . . [and] keep[s] businesses in the dark about the legal consequences of their deeds.”). In other words, the multifactor economic reality test is missing direction on the relative importance of the factors.

### 3. Confusion and Inefficiency Due to Overlapping Factors

The economic reality test’s multifactor framework gives some structure to an otherwise roving inquiry by filtering the totality of circumstances into distinct relevant categories. But three factors—skill, permanence, and integral part—have been expanded by courts and the Department to incorporate aspects of economic reality that also fall under the control factor, creating overlapping coverage. There is additional overlap between the opportunity for profit/loss and investment factors, which “relate logically to one [an] other.” *McFeeley*, 825 F.3d at 243; *Lauritzen*, 835 F.2d at 1537 (“The capital investment factor is . . . interrelated to the profit and loss consideration.”). The structure provided by a multifactor framework breaks down when the lines between factors are blurred. *See Saleem*, 854 F.3d at 140 n. 20 (“[C]aution is merited because the *Silk* factors, while helpful in identifying relevant facts, overlap to a substantial degree[.]”). Blurred lines further create inefficiency by requiring courts to analyze the same facts multiple times, sometimes in inconsistent ways. Additionally, litigants address and analyze the same facts repeatedly, and businesses must evaluate those same facts again and again when making worker classification decisions. Each of

these overlaps are discussed in more detail below.

*Silk* articulated a “skill required” factor as part of the economic reality test, 331 U.S. at 716, and several federal courts of appeals continue to apply this factor to consider “the degree of skill required to perform the work.” *Paragon*, 884 F.3d at 1235; *see also Iontchev*, 685 F. App’x at 550 (asking “whether services rendered . . . require[d] a special skill”); *Keller*, 781 F.3d at 807 (analyzing “the degree of skill required”). As explained above, this inquiry has been expanded by some other courts into a “skill and initiative” factor which, in addition to asking whether workers have “some unique skill set,” also analyzes whether they “exercise significant initiative within the business.” *Parrish*, 917 F.3d at 385; *see also, e.g., Superior Care*, 840 F.2d at 1060. The ability to exercise significant initiative is already analyzed as part of the control factor. This expansion of the skill factor to incorporate the initiative aspect of control occurred because courts recognized that “the use of special skills is not itself indicative of independent contractor status, especially if the workers do not use those skills in any independent way.” *Selker Bros.*, 949 F.2d at 1295; *see also Superior Care*, 840 F.2d at 1060. The Department now believes this sentiment could have been better incorporated into the analysis by explaining that capacity for initiative under the control factor is more important than having a specialized skill. Such an approach would have also provided helpful guidance regarding how to balance the factors that point in different directions.

Instead, courts and the Department have imported a control analysis into the skill factor. *See Selker Bros.*, 949 F.2d at 1295 (concluding that the skill factor weighed towards employee classification due to “the degree of control exercised by [the potential employer] over the day-to-day operations”); *see also WHD Fact Sheet #13* (describing the skill factor to include “initiative, judgment, or foresight”). For many courts, the analysis of control appears to have become the most important part of the skill factor, overriding presence or absence of actual specialized skill. *See Baker*, 137 F.3d at 1443 (finding that the skill factor weighed towards employee classification where skilled welders “are told what to do and when to do it”); *Superior Care*, 840 F.2d at 1060 (finding that the skill factor weighed towards employee classification for skilled nurses because “Superior Care in turn controlled the terms and conditions of the employment relationship”). In short,

by adding “initiative” to the “skill required” factor originally articulated by *Silk*, courts have turned that factor into an extension of the control factor. The “skill and initiative” factor also overlaps with the opportunity for profit or loss factor, which considers whether a worker’s earnings are determined by initiative. *See, e.g., Snell*, 875 F.2d at 810 (finding employee status in part because the workers’ “earnings did not depend upon their judgment or initiative, but on the [potential employer’s] need for their work”). Thus, facts relating to initiative are analyzed through three factors: Control, opportunity for profit, and skill.<sup>14</sup>

Such overlap exacerbates confusion by blurring the lines between the economic reality factors. It also requires redundant analysis of the same facts under different factors, which may yield inconsistent and confusing results within the same case. For example, in *Express Sixty-Minutes Delivery*, the court concluded that the control factor pointed towards independent contractor status in part because the delivery drivers had substantial capacity for initiative: “Drivers set their own hours and days of work[,] can reject deliveries without retaliation,” and “can work for other courier delivery systems.” 161 F.3d at 303. The court further determined that each “driver’s profit or loss is determined largely on his or her skill, initiative, ability to cut costs, and understanding of the courier business.” *Id.* at 304. But confusingly, the court also held that the “skill and initiative factor points towards employee status” due to “the key missing ingredient . . . [of] initiative.” *Id.* at 305. Read together, these holdings may be confusing because the court held that drivers lacked the very initiative that the court recognized in the same opinion to determine their profits and losses. It may also appear inconsistent for the court to hold that initiative was a “missing ingredient” when it determined in the same opinion that drivers had freedom to set hours, reject assignments, and work for competitors.

Next, the permanence factor originally concerned the continuity and duration of a working relationship. The factor has since been expanded by many courts and the Department to also consider the exclusivity of the relationship. *See, e.g.,*

<sup>14</sup> While both the control factor and the opportunity for profit or loss factor overlap with the “skill and initiative” factor, they do not overlap with each other in this regard. The control factor concerns the *capacity* for initiative, *i.e.*, whether a worker is able to exercise initiative. The opportunity for profit concerns the *effect* of initiative, *i.e.*, the extent to which profits (or losses) are determined by the exercise of initiative. The former is a prerequisite for the latter.



*Parrish*, 917 F.3d at 386–87 (considering as part of the permanence factor whether any worker worked exclusively for the potential employer); *Keller*, 781 F.3d at 807–09 (considering the exclusivity of the working relationship as part of the permanence factor); *Scantland*, 721 F.3d at 1319 (finding installation technicians' relationships with the potential employer were permanent because they "could not work for other companies"); *see also* WHD Opinion Letter FLSA2019–6 at 8. But exclusivity is already an aspect of control. *See, e.g., Saleem*, 854 F.3d at 141 ("[A] company relinquishes control over its workers when it permits them to work for its competitors."); *Express Sixty-Minutes Delivery*, 161 F.3d at 303 (concluding that the control factor indicated independent contractor status in part because the workers "can work for other courier delivery systems, and [their agreement] does not contain a covenant-not-to-compete"). This overlap results in exclusivity being analyzed twice in many cases,<sup>15</sup> once as part of the control factor and again as part of the permanence factor. As with initiative, such repetitive analysis is inefficient and may exacerbate confusion.

Third, the integral part factor used by some courts to analyze importance appears to be a proxy for control.<sup>16</sup> Courts appear to assume that businesses will use employees and not independent contractors to perform important work in order to control how and when that work is performed. For example, one court explained the use of this factor by stating "it is presumed that, with respect to vital or integral parts of the business, the employer will prefer to engage an employee rather than an independent contractor. This is so because the employer retains control over the employee and can compel attendan[ce] at work on a consistent basis." *Baker v. Dataphase, Inc.*, 781 F. Supp. 724, 735 (D. Utah 1992); *see also Baker v. Barnard Const. Co. Inc.*, 860 F. Supp. 766, 777 (D.N.M. 1994), *aff'd sub nom. Baker v. Flint Eng'g & Const. Co.*, 137 F.3d 1436 (10th Cir. 1998) (same). As an initial matter, this observation

appears to rest on a mistaken premise. Manufacturers, for example, commonly have critical parts and components produced and delivered by wholly separate companies. In any event, the control factor already directly analyzes whether a business can compel a worker to work on a consistent basis or otherwise closely supervise and manage performance of the work. *See, e.g., Nieman v. Nat'l Claims Adjusters, Inc.*, 775 F. App'x 622, 625 (11th Cir. 2019) ("The first factor—control—weighs in favor of independent contractor status because Nieman . . . controlled his schedule."). Such analysis presumes a relationship between control and integral part, and therefore is redundant.<sup>17</sup>

Finally, while *Silk* articulated opportunity for profit or loss and investment as separate factors, 331 U.S. at 716, there is clear overlap because "[e]conomic investment, by definition, creates the opportunity for loss, [and] investors take such a risk with an eye to profit." *Saleem*, 854 F.3d at 145 n.29. Indeed, the Supreme Court analyzed these two factors together in *Silk*, concluding that coal unloaders were employees because they had "no opportunity to gain or lose except from the work of their hands and [ ] simple tools." 331 U.S. at 717–18. In contrast, truck drivers in that case were independent contractors in part because they invested in their own trucks and had an "opportunity for profit from sound management" of that investment. *Id.* at 319.

There often is redundancy where the opportunity for profit or loss and investment factors are considered separately. *See, e.g., Mid-Atlantic Installation Servs.*, 16 F. App'x at 106–07. And separate analyses may result in confusion to the extent that it encourages analysis of a worker's investment outside of the context of the worker's opportunity for profit or loss. As discussed above, some courts compare the dollar value of a worker's personal investment against the total investment of large companies that, for example, "maintain[ ] corporate offices," *Hopkins*, 545 F.3d at 344; *see also*

*Parrish*, 917 F.3d at 383; *Keller*, 781 F.3d at 810, which says nothing about whether the worker is in business for him- or herself, as opposed to being economically dependent on the potential employer for work. Such irrelevant and potentially misleading comparisons could be avoided if investment were analyzed together with the opportunity for profit or loss factor, as the Supreme Court did in *Silk*, 331 U.S. at 719. That is precisely what the Second Circuit has done by combining opportunity for profit or loss and investment in a single factor. *See Superior Care*, 840 F.2d at 1058.

In summary, significant overlaps between factors exacerbate confusion about how certain facts are analyzed and balanced. They also create inefficiency by requiring redundant review of the same facts by courts, redundant litigation over the same facts by parties, and redundant analysis of the same facts by business seeking to classify workers.

#### 4. The Shortcomings and Misconceptions That This Proposal Seeks To Remedy Are More Apparent in the Modern Economy

Certain shortcomings of the economic reality test have become more apparent in the modern economy. In particular, technological and social change—such as falling transaction costs, the transition from more of an industrial economy to more of a knowledge economy, and shorter job tenures—have revealed how analyzing the integral part factor through the lens of importance rather than integration, and giving undue weight to the investment and permanence factors, may send misleading signals regarding an individual's classification.

First, falling transaction costs in many sectors of the economy highlight the potential for errors resulting from analyzing the integral part factor through the lens of importance instead of integration. When the transaction costs of hiring are high, firms tend to hire employees rather than independent contractors for core tasks that must be performed on a routine basis.<sup>18</sup> Thus, analyzing the importance, centrality, or frequency of the work to an organization's business may have been correlated with a worker's classification,

<sup>15</sup> Compare, e.g., *Freund*, 185 F. App'x at 783 ("Hi-Tech exerted very little control over Mr. Freund [in part because] Freund was free to perform installations for other companies."), with *id.* at 784 ("Freund's relationship with Hi-Tech was not one with a significant degree of permanence . . . [because] Freund was able to take jobs from other installation brokers.").

<sup>16</sup> As discussed above, the Supreme Court's *Rutherford* opinion did not analyze whether work was important but rather whether it was "part of an integrated unit." 331 U.S. at 729. Notably, the Fifth Circuit does not typically consider the integral part factor.

<sup>17</sup> Moreover, some courts have further conflated the integrality analysis by assuming that easily "replaceable" workers are less integral to a business. *Browning v. Ceva Freight, LLC*, 885 F. Supp. 2d 590, 610 (E.D.N.Y. 2012); *see also Velu v. Velocity Exp., Inc.*, 666 F. Supp. 2d 300, 307 (E.D.N.Y. 2009) (observing that integrality to business diminished where "work is interchangeable with the work of other[s]"). That may be true, but being easily replaceable or interchangeable makes workers more economically dependent on that business for work, not less. Thus, focusing on integrality can sometimes obscure the ultimate issue of economic dependence.

<sup>18</sup> Ronald Coase, *Nature of the Firm*, 4 *Economica* 386 (1937), <https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1468-0335.1937.tb00002.x>. *See also* Nobel Prizes and Laureates, Oct., 15, 1991, <https://www.nobelprize.org/prizes/economic-sciences/1991/press-release/> (explaining *The Nature of the Firm's* contribution to economics literature as a central reason for Coase's receipt of the 1991 Nobel Prize in Economics).

even though such analysis departs from *Rutherford Food's* consideration of whether work is part of an “integrated unit of production.” 331 U.S. at 726. Over the past several decades, however, technological innovations have driven transactions costs down in many (but not all) sectors of the economy, sometimes to negligible levels.<sup>19</sup> Firms in those sectors can now often hire independent contractors rather than employees for core tasks without incurring onerous transaction costs. For example, drivers are vital to the personal transportation business, but transportation companies increasingly hire independent contractor drivers rather than employees. See, e.g., *Saleem*, 854 F.3d at 140; *Iontchev*, 685 F. App'x at 550. The Department thus believes analyzing the importance or centrality of work may send misleading signals in low-transaction-cost environments that have become more commonplace, which militates in favor of refocusing the integral part factor on integration rather than importance.<sup>20</sup>

Second, the transition from a more industrial economy to more of a knowledge-based economy has diminished the investment factor's ability to indicate economic dependence.<sup>21</sup> Broadly speaking, the factors of production in a more industrial economy consist of either physical capital that produced investment returns or labor for which wages were paid. Such a more industrial economy facilitated a relatively clear distinction between “wage earners toiling for a living” and “independent entrepreneurs seeking a return on their risky capital investments.” *Mr. W Fireworks*, 814 F.2d at 1051. In today's more knowledge-based economy, however, it is often human rather than physical capital that matters most. Because personal initiative and know-how can enable entrepreneurship in a more knowledge-based economy, workers who lack “capital investments” cannot be assumed to be “wage earners toiling for a living.” See, e.g., *Lauritzen*, 835 F.2d at 1540–41 (Easterbrook, J.

concurring) (observing that an attorney “sells human capital rather than physical capital, but this does not imply that lawyers are ‘employees’ of their clients under the FLSA”); *Meyer v. U.S. Tennis Ass'n*, 607 F. App'x 121, 123 (2d Cir. 2015) (holding that tennis umpires were independent contractors even though they “invest little”). So, while the presence of significant capital investment is still probative, its absence may be less so in more knowledge-based occupations and industries. Indeed, technological advances enable, for example, freelance journalists, graphic designers, or consultants to be entrepreneurs with little more than a personal computer and smartphone. See, e.g., *Faludi v. U.S. Shale Sols., L.L.C.*, 950 F.3d 269, 276 (5th Cir. 2020) (holding that a consultant who “provided his own phone and computer” and “made investments in his continuing education and home office equipment” was an independent contractor).

Finally, shorter job tenures among American workers have diminished the underlying rationale of the permanence factor.<sup>22</sup> That factor assumes that independent contractors have relatively short working relationships while employees have longer ones.<sup>23</sup> Such distinction was sharp when the vast majority of employees had job tenures that lasted many years or even decades, as may have been the case for employees born in the 1940s and earlier.<sup>24</sup> But the Atlanta Federal Reserve's 2015 analysis of BLS data for U.S. workers born between 1933 and 1993 found that median job tenure has declined steadily for every age cohort, with younger generations having the lowest job tenures.<sup>25</sup> The most recently available data from the Department's Bureau of Labor Statistics (BLS) shows that, since 2014, job tenure rates have resumed their long-term decline, following a brief increase attributable to the 2008 recession, with the lowest job tenure rates for younger workers. The lowest median tenure (2.2 years) was found in the leisure and hospitality

industry, which tends to have younger workers on average. This means that many employees today have shorter working relationships with their employers, which dulls the usefulness of job duration to distinguish an employee from an independent contractor.

In summary, the Department believes the current multifactor economic reality test suffers because the analytical lens through which all the factors are to be filtered remains inconsistent; there is no clear principle regarding how to balance the multiple factors; the lines between many of the factors are blurred; and these shortcomings have become more apparent in the modern economy. The result is legal uncertainty that obscures workers' and businesses' respective rights and obligations under the FLSA. Such uncertainty is especially acute when it comes to the growing number of more flexible and nimble work relationships. While such relationships benefit workers and businesses alike, they also lead to complex questions about a worker's classification under the FLSA, which are difficult to answer due in part to the shortcomings described above.<sup>26</sup>

The Department is further concerned that continued legal uncertainty may deter innovative work arrangements by creating legal risks with respect to misclassifying workers as independent contractors instead of employees. Take, for example, the workers in WHD's April 2019 opinion letter who searched for job opportunities and negotiated for prices by “‘multi-app[ing]’—that is simultaneously run[ing] a company's virtual platform alongside the platform of a competitor to compare virtual opportunities in real time and pick the best opportunity on a job-by-job basis.” WHD Opinion Letter FLSA2019–6 at 8. Multi-apping creates significant economic value by letting workers find the best paying opportunities, providing app companies with access to a larger workforce, and helping consumers

<sup>19</sup> See, e.g., Anders Henten and Iwona Windekie, “Transaction Costs and the Sharing Economy,” 26th European Regional ITS Conference p. 2 (2015) (asserting that “digital platforms allow for decreasing transaction costs”), <https://www.econstor.eu/bitstream/10419/127145/1/Henten-Winderkilde.pdf>.

<sup>20</sup> As noted in the Background section and explained in further detail below, the Supreme Court did not analyze whether work was important, but rather whether work was “part of an integrated unit of production.” *Rutherford Food*, 331 U.S. at 726. The Department proposes to return to the Supreme Court's original factors.

<sup>21</sup> See, e.g., Walter Powell and Kaisa Snellman, *The Knowledge Economy*, 30 Annu. Rev. Sociol. 199–220 (2004).

<sup>22</sup> The Department has not investigated the cause of shorter job tenures since 1947 as part of this rulemaking.

<sup>23</sup> Compare, e.g., *Bartels*, 332 U.S. at 127 (finding that band members were independent contractors in part because “[a]most all of the engagements . . . involved were one-night stands”), with *Whitaker House*, 366 U.S. at 29 (finding that homeworkers were employees of a cooperative that “required [the homeworkers] to remain members at least a year”).

<sup>24</sup> Julie Hotchkiss and Christopher Macpherson, *Falling Job Tenure: It's Not Just about Millennials*, Federal Reserve Bank of Atlanta, June 8, 2015, <https://www.frbatlanta.org/blogs/macroblob/2015/06/08/falling-job-tenure-its-not-just-about-millennials.aspx>.

<sup>25</sup> *Id.*

<sup>26</sup> See, e.g., Kati L. Griffith, *The Fair Labor Standards Act at 80: Everything Old Is New Again*, 104 Cornell L. Rev. 557, 561 (2019) (“[N]ew trends raise complicated questions about who is a true independent contractor excluded from the [FLSA]’s protections. Most notably, the recent growth in workers who depend on freelance or ‘contract work,’ has received a lot of attention.”); Griffin Toronjo Pivateau, *The Prism of Entrepreneurship: Creating A New Lens for Worker Classification*, 70 Baylor L. Rev. 595, 625 (2018) (“The economic realities test fails to cope with innovative working arrangements.”); Keith Cunningham-Parmeter, *From Amazon to Uber: Defining Employment in the Modern Economy*, 96 B.U. L. Rev. 1673, 1683–84, 1688 (2016) (“[P]ersistent uncertainty impacts an ever-expanding list of businesses in retail, service, home care, construction, information technology, and the burgeoning on-demand economy.”).

benefit from competition. This innovative practice depends on being able to confidently classify workers as independent contractors.<sup>27</sup> For this reason, a clear standard for employee classification can help encourage multi-apping and other economic innovations. Under the status quo, a company may believe it cannot be sure of a classification outside of costly litigation applying the economic reality test (which may be too unwieldy as currently applied). The prospect of such litigation expense and any potential back wages and penalties may be enough to deter businesses from exploring innovative business models and working relationships. Thus, legal uncertainty regarding worker classification may inhibit the development of new job opportunities or result in the elimination of existing jobs.

The Department is therefore issuing this NPRM to provide greater legal certainty and solicits comments on all these issues.

#### IV. Proposed Regulatory Provisions

In light of the foregoing concerns, the Department is proposing to introduce a new part to Title 29 of the Code of Federal Regulations addressing whether particular workers are “employees” or independent contractors under the FLSA. In relevant part, and as discussed in greater detail below, the Department proposes:

- Introductory provisions at § 795.100 explaining the purpose and legal authority for the new part;
- a provision at § 795.105(a) explaining that independent contractors are not employees under the FLSA;
- a provision at § 795.105(b) discussing the “economic reality” test for distinguishing FLSA employees from independent contractors, clarifying that the concept of economic dependence turns on whether a worker is in business for him- or herself (independent contractor) or is economically

dependent on a potential employer for work (employee);

- provisions at § 795.105(c) and (d) describing factors examined as part of the economic reality test, including two “core” factors—the nature and degree of the worker’s control over the work and the worker’s opportunity for profit or loss—which are afforded greater weight in the analysis, as well as three other factors that may serve as additional guideposts in the analysis;

- a provision at § 795.110 advising that the parties’ actual practice is more relevant than what may be contractually or theoretically possible; and
- a severability provision at § 795.115.

These proposals would significantly clarify how the Department distinguishes between employees and independent contractors under the Act.

The Department welcomes comment on all aspects of its proposal.

The Department further proposes to adopt the above-described provisions as its sole and authoritative interpretation of independent contractor status under the FLSA. Accordingly, the Department would replace industry-specific interpretations of independent contractor status for sharecroppers or tenants at § 780.330(b) and certain forestry or logging operations at § 788.16(a) with cross-references to the interpretation set forth in this rule.

These previous industry-specific interpretations of independent contractor status all rely on the same FLSA terms as the interpretation set forth in this proposed rule.<sup>28</sup> As such, the Department believes the justifications articulated in the need for rulemaking discussion in Section III, particularly the need for a consistent and clear standard for determining independent contractor status in all FLSA cases, largely apply to the question of independent contractor status in those industries.

The Department considered, but is not proposing at this time, similar revisions to 29 CFR 500.20(h)(4), which addresses independent contractor status under MSPA. The Department recognizes that MSPA adopts by reference the FLSA’s definition of “employ,” see 18 U.S.C. 1802(5), and that 29 CFR 500.20(h)(4) considers “whether or not an independent contractor or employment

relationship exists under the Fair Labor Standards Act” to interpret independent contractor status under MSPA.

Nonetheless, MSPA imposes different legal obligations than the FLSA’s minimum wage and overtime pay obligations and applies to different employers and employees.<sup>29</sup> And the Department’s enforcement experience does not indicate that there is confusion regarding workers’ classifications as an employee or independent contractor in the MSPA context to the same extent as the FLSA context. As such, it is not entirely clear whether the justifications articulated in the need for rulemaking discussion in Section III apply in the MSPA context. The Department therefore proposes to proceed incrementally by first seeking comment on a revised interpretation of independent contractor status under the FLSA before considering whether to revise the MSPA regulations.<sup>30</sup> The Department welcomes comments regarding whether 29 CFR 500.20(h)(4) should be revised to be consistent with the interpretation of independent contractor status set forth in this proposed rule.

##### A. Introductory Statements

Proposed § 795.100 explains that the interpretations provided in part 795 will guide WHD’s enforcement of the FLSA and are intended to be used by employers, businesses, the public sector, employees, workers, and courts to assess employment status classifications under the Act. Proposed § 795.100 further clarifies that, if proposed part 795 is adopted, employers may safely rely upon the interpretations provided in part 795 under section 10 of the Portal-to-Portal Act, unless and until any such interpretation “is modified or rescinded or is determined by judicial authority to be invalid or of no legal effect.” 29 U.S.C. 259.

<sup>29</sup> See WHD Fact Sheet #49, “The Migrant and Seasonal Agricultural Worker Protection Act” (Jul. 2008).

<sup>30</sup> See, e.g., *Pharm. Research & Mfrs. of Am. v. FTC.*, 790 F.3d 198, 203 (D.C. Cir. 2015) (affirming that agency had discretion to “proceeding incrementally” in promulgating rules that were directed to one industry but not others); *Inv. Co. Inst. v. Commodity Futures Trading Comm’n*, 720 F.3d 370, 378 (D.C. Cir. 2013) (observing that “[n]othing prohibits federal agencies from moving in an incremental manner” (quoting *F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 522 (2009)); *City of Las Vegas v. Lujan*, 891 F.2d 927, 935 (D.C. Cir. 1989) (noting that “agencies have great discretion to treat a problem partially”).

<sup>27</sup> Businesses have a strong incentive to restrict multi-apping to independent contractors because an employee who multi-apps may create complicated questions regarding which of the multiple app companies is responsible for FLSA obligations for time spent multi-apping. During the multi-app period, a worker would be searching for customers on behalf of multiple app companies, and it therefore may be difficult or impractical to determine the company or companies for which the worker is performing compensable work if he or she is a non-exempt employee. This could raise challenging questions that create legal risk for each employer. The Department believes that the greater the legal certainty of workers’ respective classifications, the more the Department encourages innovative work arrangements like multi-apping by providing companies with clear frameworks to set up these arrangements.

<sup>28</sup> The interpretation of independent contractor status under § 780.330(b) for sharecroppers or tenants pertain to an exemption for certain “employee[s] employed in agriculture” under section 13(a)(6) of the FLSA. The Department believes the distinction this proposed rule draws between independent contractors and employees would apply in the agricultural exemption context because the same statutory terms, i.e., employee and employ, are being interpreted.

*B. Proposal To Explain That Independent Contractors Are Not Employees Under the Act*

Proposed § 795.105(a) explains that an independent contractor who renders services to a person is not an employee of that person under the FLSA. This is consistent with the Supreme Court's affirmation in *Rutherford Food* that the Act's definition of employee has consistently been interpreted as excluding individuals who "might work for their own advantage," including "independent contractors who take part in production or distribution." 331 U.S. at 728–29; *see also, e.g., Hopkins*, 545 F.3d at 342; *Saleem*, 854 F.3d at 139–40; *Karlson*, 860 F.3d at 1092. Minimum wage and overtime pay requirements under sections 6 and 7 of the Act apply only to a person's employees. *See* 29 U.S.C. 206(a), 207(a)(1). As such, those requirements do not apply with respect to a person's independent contractors. For the same reason, the recordkeeping obligations for employers under section 11 of the Act do not apply to a person with respect to services received from an independent contractor. *See* 29 U.S.C. 211(c) ("Every employer subject to any provision of [the FLSA] shall make, keep, and preserve such records of the persons employed by him[.]") (emphasis added).

*C. Proposal To Adopt the Economic Reality Test To Determine a Worker's Employee or Independent Contractor Status Under the Act*

Proposed § 795.105(b) adopts the economic reality test to determine a worker's status as an employee or an independent contractor under the Act.

The Department's analysis begins with the text of the statute, following well-settled principles of statutory construction by "reading the whole statutory text, considering the purpose and context of the statute, and consulting any precedents or authorities that inform the analysis." *Kasten v. Saint-Gobain Performance Plastics Corp.*, 563 U.S. 1, 7 (2011) (interpreting the FLSA) (internal quotation marks and citation omitted). An employer employs an individual under the Act if the employer "suffer[s] or permit[s]" the individual to work. 29 U.S.C. 203(g). Proposed § 795.105(b) codifies the Supreme Court's statement that "suffer or permit" means something broader than the common law conception of control; namely, economic dependence. *See, e.g., Darden*, 503 U.S. at 326. Therefore, the Department proposes that the central inquiry as to whether an individual is an employee or independent contractor under the Act is

whether, as a matter of economic reality, the individual is economically dependent on the potential employer for work. *See Pilgrim Equip.*, 527 F.2d at 1311 ("It is dependence that indicates employee status.").

However, all workers—employees and independent contractors alike—are economically dependent on others to some degree. Business owners are likewise economically dependent on the workers they hire, but this does not make them employees of their own workers. The economic reality test can be "a dimensionless and amorphous abstraction" unless its touchstone—economic dependence—is clarified. *Webb*, 397 U.S. at 188 (quoting S. Rep. No. 1255, at 12 (1948)). As explained in the need for rulemaking discussion earlier in Section III, the meaning of economic dependence is sometimes inconsistently applied and would benefit from further explanation.

Clarifying the test requires putting the question of economic dependence in the proper context. "Economic dependence is not conditioned reliance on an alleged employer for one's primary source of income, for the necessities of life." *Mr. W Fireworks*, 814 F.2d at 1054. Rather, courts have framed the question as "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." *Saleem*, 854 F.3d at 139; *see also Parrish*, 917 F.3d at 379; *Baker*, 137 F.3d at 1440 ("[T]he focal point is whether the individual is economically dependent on the business to which he renders service . . . or is, as a matter of economic fact, in business for himself.") (internal quotation marks and citation omitted); *Donovan v. Tehco, Inc.*, 642 F.2d 141, 143 (5th Cir. 1981) ("The focal inquiry in the characterization process is thus whether the individual is or is not, as a matter of economic fact, in business for himself."). In other words, the key question is whether workers are "more closely akin to wage earners," who depend on others to provide work opportunities, or "entrepreneurs," who create work opportunities for themselves. *Mr. W Fireworks*, 814 F.2d at 1051; *see also Express Sixty-Minutes*, 161 F.3d at 305 (asking whether workers "are more like wage earners than independent entrepreneurs"); *cf. H.R. Rep. No. 245*, 80th Cong., 1st Sess. 18 (1947) ("'Employees' work for wages or salaries under direct supervision. 'Independent contractors' undertake to do a job for a price, decide how the work will be done, usually hire others to do the work, and depend for their income not upon wages, but upon the

difference between what they pay for goods, materials, and labor and what they receive for the end result, that is, upon profits.'").

The above-described concept of economic dependence comports with the FLSA's definition of employ as "includ[ing] to suffer or permit to work." *See* 29 U.S.C. 203(g). An individual who depends on a potential employer for work is able to work only by the sufferance or permission of the potential employer. Such an individual is therefore an employee under the Act. In contrast, an independent contractor does not work at the sufferance or permission of others because, as a matter of economic reality, he or she is in business for him- or herself. In other words, an independent contractor is an entrepreneur who works for him- or herself, as opposed to an employer.

Some courts have relied on a worker's entrepreneurship with respect to one type of work to conclude that the worker was also in business for him- or herself in a second, unrelated type of work. *See, e.g., Parrish*, 917 F.3d at 384 (considering "plaintiff's enterprise, such as the goat farm, as part of the overall analysis of how dependent plaintiffs were on [defendant]" for working as consultants); *Thibault*, 612 F.3d at 849 (concluding that plaintiff was an independent contractor as a cable splicer in part because he managed unrelated commercial operations and properties in a different state). However, the Supreme Court was clear that the economic reality analysis is limited to "the claimed independent operation." *Silk*, 331 U.S. at 716. Thus, the relevant question in this context is whether the worker providing certain service to a potential employer is an entrepreneur "in that line of business." *Mr. W Fireworks*, 814 F.2d at 1054. Otherwise, businesses must make worker classification decisions based on facts outside the working relationship, such as whether a consultant manages a "goat farm," *Parrish* 917 F.3d at 384, or whether a cable splicer owns an out-of-state commercial venture. *Thibault*, 612 F.3d at 849.<sup>31</sup>

At bottom, the phrase "economic dependence" may mean many different things. But in the context of the economic reality test, "economic dependence" is best understood in terms of what it is not. The phrase excludes individuals who, as a matter of economic reality, are in business for themselves. Such individuals work for themselves rather than at the sufferance

<sup>31</sup> It is possible for a worker to be an employee in one line of business and an independent contractor in another.

or permission of a potential employer, *see* 29 U.S.C. 203(g), and thus are not dependent on that potential employer for work. Proposed § 795.105(b) therefore recognizes the principle that, as a matter of economic reality, workers who are in business for themselves with respect to work being performed are independent contractors for that type of work.

*D. Proposal To Apply the Economic Reality Factors To Determine a Worker's Independent Contractor or Employee Status*

The uncertainty and unpredictability of the traditional multifactor analysis of economic dependence has led some courts and commentators to call for alternative approaches. Judge Easterbrook's concurrence in *Lauritzen*, for instance, urged the Seventh Circuit to "abandon these unfocused 'factors' and start again." 835 F.2d at 1543 (Easterbrook J., concurring). One commentator in a recent article has proposed replacing the economic reality factors with "three main dimensions to entrepreneurship."<sup>32</sup> The Department, however, prefers to sharpen the existing test, rather than to create a new test out of whole cloth, in part because many existing work relationships are structured around the current multifactor test and wholesale abandonment of that test may impose undue and prohibitive adjustment costs on the regulated community. Moreover, the economic reality test, properly construed and applied, is effective at distinguishing employees from independent contractors. As such, proposed § 795.105(c) and (d) would adopt a variation on the traditional multifactor analysis of economic dependence to improve certainty and predictability, as well as increase the test's probative value into the underlying question of economic dependence.

Proposed § 795.105(c) explains that certain nonexclusive economic reality factors guide the determination of whether an individual is, on one hand, economically dependent on a potential employer and therefore an employee or, on the other, in business for him- or herself and therefore an independent contractor. These factors are listed in § 795.105(d) and are based on economic reality factors currently used by the Department and most federal courts of

appeals, with certain proposed clarifications.

First, the Department proposes to follow the Second Circuit's approach of analyzing the worker's investment as part of the opportunity for profit or loss factor. 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. Second, the Department proposes to clarify that the "skill required" factor originally articulated by the Supreme Court should be used, as opposed to the "skill and initiative" factor currently used in some circuits, because considering initiative as part of the skill factor creates unnecessary and confusing overlaps with the control and opportunity for profit or loss factors. Third, the Department proposes to further reduce overlap by analyzing the exclusivity of the relationship as a part of the control factor only, as opposed to both the control and permanence factors. Lastly, the Department proposes to reframe the "whether the service rendered is an integral part of the alleged employer's business" factor in accordance with the Supreme Court's original inquiry of whether the work is "part of an integrated unit of production." *See Rutherford*, 331 U.S. at 729.

Proposed § 795.105(c) further improves the certainty and predictability of the test by focusing it on two core factors: (1) The nature and degree of the worker's control over the work; and (2) the worker's opportunity for profit or loss. These core factors, listed in proposed § 795.105(d)(1), are highly probative to the inquiry because the ability to control one's work and to earn profits and risk losses strikes at the core of what it means to be an entrepreneurial independent contractor, as opposed to a "wage earner" employee. *Mr. W Fireworks*, 814 F.2d at 1051; *cf. FedEx Home Delivery v. NLRB*, 563 F.3d 492, 497 (D.C. Cir. 2009) ("[I]ndependent contractors have 'significant entrepreneurial opportunity for gain or loss[.]'"). Other factors listed in proposed § 795.105(d)(2) are also probative depending on the circumstances, but should be evaluated in the context of these two core factors. Given their greater weight, if both proposed core factors point towards the same classification—whether employee or independent contractor—there is a substantial likelihood that the individual's classification is accurate. This is because it is highly unlikely for the other, less probative factors to

outweigh the combined weight of the core factors.<sup>33</sup>

The following discussion addresses the five economic reality factors, including proposed modifications and clarifications made to each, and explains why the two core factors are entitled to greater weight than other factors.

**1. The Nature and Degree of the Individual's Control Over the Work**

The first economic reality factor (proposed § 795.105(d)(1)(i)) is "the nature and degree of the individual's control over the work."<sup>34</sup> This factor would weigh towards the individual being an independent contractor to the extent that the individual, as opposed to the potential employer, exercises substantial control over key aspects of the performance of the work. Examples in the proposed regulatory text of an individual's substantial control include setting his or her own work schedule, choosing assignments, working with little or no supervision, and being able to work for others, including a potential employer's competitors.<sup>35</sup> In addition, the Department agrees with courts that have found that an individual worker's "substantial control of the key aspects" of the work weighs in favor of independent contractor classification "even if the worker is not solely in control of the work." *Parrish*, 917 F.3d at 381–82; *see also Mid-Atl. Installation Servs.*, 16 F. App'x at 106 (affirming the

<sup>33</sup> As discussed in greater detail below, the Department's review of federal appellate decisions indicates that, when the two proposed core factors are in alignment, they point to what the court finds to be the individual's correct classification.

<sup>34</sup> Many courts articulate this factor as the degree of control over the work by the potential employer as opposed to by the worker. *See, e.g., Razak*, 951 F.3d at 142; *Hobbs*, 946 F.3d at 829; *McFeeley*, 825 F.3d at 241; *Keller*, 781 F.3d at 807; *Scantland*, 721 F.3d at 1312. This distinction, however, is of no consequence. As the proposed regulatory text and this accompanying discussion make clear, the nature and degree of control over the work by the worker and by the potential employer are considered to determine whether control indicates employee or independent contractor status.

<sup>35</sup> *See, e.g., Saleem*, 854 F.3d at 147 (noting that the workers' "flexible work schedules and considerable control over when, where, and in what circumstances to accept a . . . fare" indicated that they were independent contractors); *Parrish*, 917 F.3d at 382 (finding control factor favored independent contractor status where workers "did not have to accept a project" and occasionally "turned down projects without negative repercussion"); *Thibault*, 612 F.3d at 847 (finding control factor favored independent contractor status where "supervisors would only come by occasionally, and never specified how [the worker] should do the [work]"); *Express Sixty-Minutes Delivery*, 161 F.3d at 303 (determining that the potential employer "had minimal control" over the delivery drivers where drivers "set their own hours and days of work," "can work for other courier delivery systems," and "can reject deliveries without retaliation").

<sup>32</sup> Piveteau, *supra* note 26, at 631. The proposal would replace the six-factor approach with "the three main dimensions to entrepreneurship," which are: "(1) the processes and events that make up entrepreneurship; (2) the skills and traits that characterize an entrepreneur; and (3) the results that entrepreneurship generates." *Id.*

district court's conclusion that, although the potential employer exercised some control over the work, the manner in which the workers completed their work was "left to their broad discretion and business judgment, which suggests that they are independent contractors").

In contrast, the control factor would weigh in favor of classification as an employee to the extent that a potential employer, as opposed to the individual, exercises substantial control over key aspects of the work, including through requirements that the individual work exclusively for it during the working relationship or prohibiting the individual from working for others after that relationship ends. According to the proposed regulatory text, a potential employer may exercise substantial control, for example, where it explicitly requires an exclusive working relationship or where it imposes restrictions that effectively prevent an individual from working with others. *Cf. Keller*, 781 F.3d at 814 ("[A] reasonable jury could find that the way that [the potential employer] scheduled [the worker's] installation appointments made it impossible for [the worker] to provide installation services for other companies."); *Baker*, 137 F.3d at 1441 ("[T]he hours [the workers] are required to work on a project (ten to fourteen hours a day, six days a week), coupled with driving time between home and often remote work sites each day, make it practically impossible for them to offer services to other employers."). However, a "non-disclosure agreement does not require exclusive employment." *Parrish*, 917 F.3d at 382; *see also Talbert*, 405 F. App'x at 85 ("[T]here is nothing in the confidential agreement that would have precluded . . . working for other[s].").

Proposed § 795.105(d)(1)(i) clarifies that requiring an 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 relationships) does not constitute control that makes the individual more or less likely to be an employee under the Act. These requirements frequently apply to work performed by employees and independent contractors alike; as such, they are not probative as to whether a working relationship is one of employment or independent contracting. The case law supports this approach. *See, e.g., Iontchev*, 685 F. App'x at 550 (noting that the potential employer's "disciplinary policy

primarily enforced the Airport's rules and [the city's] regulations governing the [drivers'] operations and conduct" in finding that the potential employer exercised "relatively little control over the manner in which the [d]rivers performed their work"); *Mid-Atl. Installation Servs.*, 16 F. App'x at 106 (rejecting an argument that backcharging the workers "for failing to comply with various local regulations or with technical specifications demonstrates the type of control characteristic of an employment relationship," and noting that withholding money in such circumstances is common in contractual relationships); *Mr. W Fireworks*, 814 F.2d at 1048 (finding that, because a scheduling requirement was imposed by the potential employer and not by state law, it suggested control over the workers).

In addition, this aspect of the Department's proposal is supported by case law regarding FLSA joint employer status. For example, the Second Circuit agreed that control with respect to "contractual warranties of quality and time of delivery has no bearing on the joint employment inquiry" because such control is "perfectly consistent with a typical, legitimate subcontracting relationship." *Zheng v. Liberty Apparel Co. Inc.*, 355 F.3d 61, 75 (2d Cir. 2003).<sup>36</sup>

Moreover, control exercised by a potential joint employer over a contractor's employees to "ensure compliance with various safety and security regulations" has been found to be "qualitatively different" from control that indicates employer status. *Moreau v. Air France*, 356 F.3d 942, 950–51 (9th Cir. 2003). Accordingly, the Department agrees with the above case law that the types of control listed in the last sentence of proposed § 795.105(d)(1)(i) are "qualitatively different" from control that evinces employer status. *Moreau*, 343 F.3d at 1189; *see also Iontchev*, 685 F. App'x at 550; *Mid-Atlantic Installation Servs.*, 16 F. App'x at 106; *Mr. W Fireworks*, 814 F.2d at 1048; *Freund*, 185 F. App'x at 783. The Department welcomes comment

<sup>36</sup> *See also, e.g., Godlewska v. HDA*, 916 F. Supp. 2d 246, 259 60 (E.D.N.Y. 2013), *aff'd sub nom. Godlewska v. Human Dev. Ass'n, Inc.*, 561 F. App'x 108 (2d Cir. 2014) ("Quality control and compliance monitoring . . . are qualitatively different from control that stems from the nature of the relationship between the employees and the putative employer." (quotation marks omitted)); *Jacobson v. Comcast Corp.*, 740 F. Supp. 2d 683, 691–92 (D. Md. 2010) (holding that the potential joint employer's "quality control procedures . . . [were] qualitatively different from the control exercised by employers over employees"); *Thornton v. Charter Commc'ns, LLC*, No. 4:12CV479 SNLJ, 2014 WL 4794320, at \*16 (E.D. Mo. Sept. 25, 2014) (same).

regarding this approach, including the distinction being drawn between bona fide quality control measures and control that is indicative of an employment relationship.

## 2. The "Opportunity for Profit or Loss" Factor

The second economic reality factor (proposed § 795.105(d)(1)(ii)) is "the individual's opportunity for profit or loss." In analyzing this factor, courts generally consider whether such opportunities are based on personal initiative, managerial skill, or business acumen.<sup>37</sup> The Second Circuit also considers the individual's opportunity for profit or loss based on investments. *See Superior Care*, 840 F.2d at 1060. The Department and courts of appeals outside of the Second Circuit have traditionally analyzed "opportunity for profit or loss" and "investment" as separate factors, but at least some of those courts recognize that the two are "interrelated." *Lauritzen*, 835 F.2d at 1537; *see also McFeeley*, 825 F.3d at 243. The Department believes the Second Circuit's approach of combining the factors is preferable because it minimizes duplicative analysis of the same facts under different factors and aligns more closely with the Supreme Court's original analysis in *Silk*, 331 U.S. at 717–19.

As explained in the need for rulemaking discussion in Section III, treating "opportunity for profit or loss" and "investment" as separate factors results in duplicative analysis of the same facts. For example, in *Mid-Atlantic Installation Services*, the Fourth Circuit found that the opportunity for profit or loss factor weighed in favor of independent contractor status because the cable installer's "net profit or loss depends on [in part] . . . the business acumen with which the Installer makes

<sup>37</sup> *See, e.g., Karlson*, 860 F.3d at 1094–95 (discussing how the worker's decisions and choices regarding assignments and customers affected his profits); *Saleem*, 854 F.3d at 145 (noting in support of independent contractor status that the degree to which the worker's relationship with the potential employer "yielded returns was a function . . . of the business acumen of each [worker]"); *McFeeley*, 825 F.3d at 243 ("The more the worker's earnings depend on his own managerial capacity rather than the company's . . . the less the worker is economically dependent on the business and the more he is in business for himself and hence an independent contractor.") (internal quotation marks omitted); *Express Sixty-Minutes*, 161 F.3d at 304 (agreeing with district court that "driver's profit or loss is determined largely on his or her skill, initiative, ability to cut costs, and understanding of the courier business."); WHD Opinion Letter FLSA2019–6 at 6 ("These opportunities typically exist where the worker receives additional compensation based, not [merely] on greater efficiency, but on the exercise of initiative, judgment, or foresight.").

his required capital investments in tools, equipment, and a truck.” 16 F. App’x at 106. The court further held that the investment factor also pointed in that direction based on those same facts, *i.e.*, the installers “suppl[ied] their own trucks (equipped with 28-foot ladders), specialized tools, uniforms, and pagers.” *Id.* at 107. Such duplicative analysis is unwieldy, and it can be potentially confusing where the two factors analyzing the same facts reach opposite conclusions regarding a worker’s classification. *See, e.g., Parrish*, 917 F.3d at 382–85; *Cromwell*, 348 F. App’x at 61.

The Second Circuit avoids duplication and potential confusion by analyzing investment and opportunity for profit or loss together. Under this approach, the worker’s meaningful capital investments may evince opportunity for profit or loss: “[e]conomic investment, by definition, creates the opportunity for loss, [and] investors take such a risk with an eye to profit.” *Saleem*, 854 F.3d at 145 n.29. But investment is not the only way to satisfy this factor because workers who “invest little” may nonetheless have an opportunity for profit through the exercise of personal initiative. *Meyer*, 607 F. App’x at 121; *accord Parrish*, 917 F.3d at 384–85; *Express Sixty-Minutes*, 161 F.3d at 304. In short, meaningful investment is a sufficient but not necessary dimension of the opportunity for profit or loss. *See Lauritzen*, 835 F.2d at 1540–41 (Easterbrook, J. concurring) (“[P]ossess[ing] little or no physical capital . . . is true of many workers we would call independent contractors. Think of lawyers, many of whom do not even own books. The bar sells human capital rather than physical capital, but this does not imply that lawyers are ‘employees’ of their clients under the FLSA.”); *see also Faludi*, 950 F.3d at 275 (“Faludi provided his own phone and computer” and “made investments in his continuing education and home office equipment”).

The Second Circuit’s approach of combining opportunity for profit or loss and investment is also more faithful to the Supreme Court’s original analysis in *Silk*. *See* 331 U.S. at 716. In that case, the Court listed the two factors separately but analyzed them together. In particular, the Court found that coal unloaders were employees because they had “no opportunity to gain or lose except from the work of their hands and [ ] simple tools,” while truck drivers who invested in their own vehicles had “opportunity for profit from sound management” of that investment by, for instance, hauling for different customers. *Id.* at 719. Thus the question

is whether workers are more like unloaders whose profits were based solely on “the work of their hands and [ ] simple tools” or the drivers whose profits depended on their initiative and investments. *See id.*; *see also Rutherford Food*, 331 U.S. at 730 (concluding that workers were employees in part because their opportunity for profit “was more like piecework than an enterprise that actually depended for success upon the initiative, judgment or foresight of the typical independent contractor”).

Not all courts follow the Second Circuit and the Supreme Court’s approach of analyzing investment through the lens of profit and loss. Some, for instance, “use[ ] a side-by-side comparison method” that directly “compare[s] ‘each worker’s individual investment to that of the alleged employer.’” *Parrish*, 917 F.3d at 383 (quoting *Hopkins*, 545 F.3d at 344); *see also, e.g., Keller*, 781 F.3d at 810 (agreeing that “courts must compar[e] the worker’s investment in the equipment to perform his job with the [potential employer’s] total investment”). In *Hopkins*, for example, the Fifth Circuit held that insurance sales leaders’ investments were insignificant because “it is clear that [the insurance company’s] investment—including maintaining corporate offices, printing brochures and contracts, providing accounting services, and developing and underwriting insurance products—outweighs the personal investment of any one Sales Leader.” 545 F.3d at 344.

But such a “side-by-side comparison method” does not illuminate the ultimate question of economic dependence. *See Karlson*, 860 F.3d at 1096 (“[C]omparing the amount Karlson spent . . . with [potential employer’s] total expenses in operating APS has little relevance . . . [because] [l]arge corporations can hire independent contractors, and small businesses can hire employees.”). Indeed, it merely highlights the obvious and unhelpful fact that individual workers—whether employees or independent contractors—likely have fewer resources than businesses that, for example, “maintain[ ] corporate offices,” *see Hopkins*, 545 F.3d at 344, or drill oil wells, *see Parrish*, 917 F.3d at 383 (“Obviously, [the oil drilling company] invested more money at a drill site compared to each plaintiff’s investments.”). In contrast, analyzing investment as part of individuals’ opportunity for profit or loss illuminates the ultimate inquiry of whether individuals are “more closely akin to wage earners toiling for a living, than to independent entrepreneurs seeking a

return on their risky capital investments.” *Mr. W. Fireworks*, 814 F.2d at 1051.

The Department is therefore proposing to adopt an approach similar to that of the Second Circuit, which analyzes the worker’s investment as part of the opportunity for profit or loss factor. The combined factor would weigh towards the individual being classified as an independent contractor if he or she has an opportunity for profit or loss based on either or both: (1) The exercise of personal initiative, including managerial skill or business acumen; and/or (2) the management of investments in, or capital expenditure on, for example, helpers, equipment, or material. While the effects of the individual’s exercise of initiative and management of investment are both considered under this factor, for reasons explained above, the individual would not need to have an opportunity for profit or loss based on both for this factor to weigh towards the individual being an independent contractor. This factor would weigh towards the individual being an employee to the extent the individual is unable to affect his or her earnings through initiative or investment or is only able to do so by working more hours or more efficiently.<sup>38</sup>

The Department also considered keeping opportunity for profit or loss and investment as separate factors in its proposal, but believes that approach may be needlessly duplicative and confusing for reasons stated above. If investment were kept as a separate factor, the Department would emphasize that the factor should not reconsider opportunity for profit or loss. Instead, it would focus on whether a worker’s investment (or lack thereof) in the equipment, materials, technology, etc. necessary to perform the worker’s work

<sup>38</sup> Workers who are paid on a piece-rate basis are an example of workers who are able to affect their earnings only through working more hours or more efficiently. Courts have generally agreed that such workers lack meaningful opportunity for profit or loss. *See, e.g., Whitaker House*, 366 U.S. at 33 (plaintiffs who manufactured knitted goods at home were employees under the FLSA, in part, because “[t]he management fixes the piece rates at which they work”); *Hodgson v. Cactus Craft of Arizona*, 481 F.2d 464, 467 (9th Cir. 1973) (persons who manufacture novelty and souvenir gift items at homes and were compensated at a piece rate were employees under the FLSA). In *DialAmerica*, 757 F.2d at 1385, for example, the Third Circuit held that homeworkers who were paid on a piece-rate basis to perform the simple service of researching telephone numbers were employees who lacked meaningful opportunity for profit or loss. In contrast, distributors who recruited and managed researchers and were paid based on the productivity of those they managed were independent contractors, in part, because distributors’ earnings depended on “business-like initiative.” *Id.* at 1387.



renders the worker more or less economically dependent on the potential employer for work. The Department welcomes comments on this alternative approach.

### 3. The “Skill Required” Factor

“The amount of skill required for the work” is an economic reality factor under proposed § 795.105(d)(2)(i). The Supreme Court articulated the “skill required” factor in *Silk*, 331 U.S. at 716, which several courts of appeals continue to consider as “the degree of skill required to perform the work.” *Paragon*, 884 F.3d at 1235; *see also Iontchev*, 685 F. App’x at 550; *Keller*, 781 F.3d at 807. The Department and other courts of appeals, however, have traditionally expanded this factor to include consideration of “initiative” and “judgment.” *See, e.g., Parrish*, 917 F.3d at 379; *Karlson*, 860 F.3d at 1093; *Superior Care*, 840 F.2d at 1058–59; *see also* WHD Fact Sheet #13. This expansion was intended to increase the probative value of the skill factor by analyzing therein the worker’s capacity to “exercise significant initiative within the business.” *See Parrish*, 917 F.3d at 379; *see also Selker Bros.*, 949 F.2d at 1295 (“[T]he use of special skills is not itself indicative of independent contractor status, especially if the workers do not use those skills in any independent way.”); *Superior Care*, 840 F.2d at 1060 (same). But the worker’s capacity to exercise on-the-job initiative is already analyzed in multiple ways under the control factor, including, for example, whether the worker controls the means and manner of work, decides when to work, or choice of assignments. *Express Sixty-Minutes*, 161 F.3d at 304. And the effects of a worker’s initiative are already analyzed as part of the opportunity for profit or loss factor. *Id.*

As explained in the need for rulemaking discussion in Section III, importing aspects of the control factor into the skill factor has diluted the consideration of actual skill to the point of near irrelevance. In many cases, analysis of control rather than skill drives whether the skill factor favors independent contractor or employee status. *See, e.g., Selker Bros.*, 949 F.2d at 1295; *Baker*, 137 F.3d at 1443; *Superior Care*, 840 F.2d at 1060. The Department believes such dilution generates confusion regarding the relevance and weight of the worker’s skill in the evaluation of economic dependence. It also blurs the lines between the economic reality factors, thereby undermining the structural benefits of a multifactor test. Furthermore, as at least one court of appeals has found, workers can exercise

enough initiative to have a meaningful opportunity for profit or loss but apparently not enough to satisfy the “skill and initiative required” factor. *Express Sixty-Minutes*, 161 F.3d at 304–05. This calls into question the relevance of initiative as part of a separate skill factor.

The Department therefore proposes to clarify that this factor should focus on the “amount of skill required,” as originally articulated by the Supreme Court in *Silk*, 331 U.S. at 716, and used today by several courts of appeals, *see, e.g., Paragon*, 884 F.3d at 1235; *Iontchev*, 685 F. App’x at 550; *Keller*, 781 F.3d at 807. Notably, this factor would not include a consideration of “initiative” (or the related concepts of judgment and foresight) because facts related to initiative are considered as part of the control and opportunity for profit or loss factors. Proposed § 795.105(d)(2)(i) thus explains that the “skill required” factor weighs in favor of classification as an independent contractor where the work at issue requires specialized training or skill that the potential employer does not provide. Otherwise, it weighs in favor of classification as an employee.

The Department believes that this approach would sharpen the distinction between the economic reality factors by focusing on skill, as opposed to aspects of control. The worker’s ability to exercise initiative would remain more important than the presence of skill because it would be analyzed under the control factor, a core factor that would be given more weight than the skill factor. And the effect of the worker’s initiative would be analyzed under the opportunity for profit or loss factor, another core factor that would be given more weight. The Department considered keeping initiative as an aspect of the skill factor, but believes that such an approach may be needlessly duplicative and confusing for the reasons stated above. The Department welcomes comment on this alternative approach.

### 4. The “Permanence of the Working Relationship” Factor

“The degree of permanence of the working relationship between the individual and the potential employer” is an economic reality factor under proposed § 795.105(d)(2)(ii). Courts and the Department routinely consider this factor when applying the economic reality analysis under the FLSA to determine employee or independent contractor status. *See, e.g., WHD Opinion Letter FLSA2019–6* at 4; *Razak*, 951 F.3d at 142; *Hobbs*, 946 F.3d at 829; *Karlson*, 860 F.3d at 1092–93; *McFeeley*,

825 F.3d at 241; *Keller*, 781 F.3d at 807; *Scantland*, 721 F.3d at 1312. However, they sometimes redundantly analyze the exclusivity of the working relationship as part of the permanence factor. The control factor already considers whether a worker has freedom to pursue external opportunities by working for others, including a potential employer’s rivals. *See, e.g., Freund*, 185 F. App’x at 783 (affirming district court’s finding that “Hi-Tech exerted very little control over Mr. Freund,” in part, because “Freund was free to perform installations for other companies”).<sup>39</sup> The same concept of exclusivity is then re-analyzed as part of the permanence factor. *Compare id.* (“Freund’s relationship with Hi-Tech was not one with a significant degree of permanence . . . [because] Freund was able to take jobs from other installation brokers.”), *with Scantland*, 721 F.3d at 1319 (finding installation technicians’ relationships with the potential employer were permanent because they “could not work for other companies”).

Such duplicative analysis of exclusivity under the permanence factor is not supported by the Supreme Court’s original articulation of that factor in *Silk*. *See* 331 U.S. at 716 (analyzing the “regularity” of unloaders’ work); *id.* at 719 (analyzing truck drivers’ ability to work “for any customer” as an aspect of “the control exercised” but not permanence); *see also* 12 FR 7967 (describing the permanence factor as pertaining to “continuity of the relation” but with no reference to exclusivity). Nor is the concept of exclusivity part of the common understanding of the word “permanent.”<sup>40</sup> In a similar vein to the Department’s analysis of the concept of initiative, the Department believes analysis of exclusivity as part of the permanence factor dilutes the significance of actual permanence within that factor, blurs the lines between the economic reality factors,

<sup>39</sup> In addition, the opportunity for profit or loss factor considers whether a worker’s decisions to work for others affects profits or losses. *See, e.g., Freund*, 185 F. App’x at 783 (affirming the district court’s finding that the “looseness of the relationship between Hi-Tech and Freund permitted him great ability to profit,” in part, because “Freund could have accepted installation jobs from other companies.”). The Department does not believe this consideration overlaps with the control factor. While the control factor concerns the ability to work for others, the opportunity for profit or loss factor concerns the effects of doing so.

<sup>40</sup> *See* Merriam-Webster Dictionary, <https://www.merriam-webster.com/dictionary/permanent> (defining permanent as “continuing or enduring without fundamental or marked change”); *see also* Oxford American Dictionary 1980 (defining permanent as “lasting or meant to last indefinitely”); Merriam-Webster Pocket Dictionary 1947 (defining permanent as “Lasting; enduring”).

and creates confusion by incorporating a concept that is distinct from permanence.

Because the worker's ability to work for others is already analyzed as part of the control factor, proposed § 795.105(d)(2)(ii) articulates the permanence factor without referencing the exclusivity of the relationship between the worker and potential employer. This proposal does not require any changes to the articulation of this factor because the current articulation, *i.e.*, "the permanency of the working relationship," provides no hint that exclusivity is also considered. This approach would focus the permanence factor on the continuity and duration of the working relationship, which align both with how the factor was originally articulated and with the plain meaning of "permanence." The permanence factor would weigh in favor of an individual being classified as an independent contractor where his or her working relationship with the potential employer is by design definite in duration or sporadic. In contrast, the factor would weigh in favor of classification as an employee where the individual and the potential employer have a working relationship that is by design indefinite in duration or continuous. The Department notes that the 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. *See Paragon Contractors*, 884 F.3d at 1236–37.

The Department also considered keeping exclusivity as part of this factor but changing the articulation to "permanence and exclusivity of the working relationship" to be more accurate. However, the Department believes that such an approach may be needlessly duplicative and confusing for the reasons stated above. The Department welcomes comments on this alternative approach.

##### 5. The "Integrated Unit" Factor

The Department and courts outside of the Fifth Circuit have typically articulated the sixth factor of the economic reality test as "the extent to which services rendered are an integral part of the [potential employer's] business." WHD Fact Sheet #13. Under this articulation, the "integral part" factor considers "the importance of the services rendered to the company's business." *McFeeley*, 825 F.3d at 244. In line with this thinking, courts generally state that this factor favors employee

status if the work performed is so important that it is central to or at "[t]he heart of [the potential employer's] business." *Werner v. Bell Family Med. Ctr., Inc.*, 529 F. App'x 541, 545 (6th Cir. 2013); *see also Baker*, 137 F.3d at 1443 ("[R]ig welders' work is an important, and indeed integral, component of oil and gas pipeline construction work."); *Lauritzen*, 835 F.2d at 1537–38 ("[P]icking the pickles is a necessary and integral part of the pickle business[.]"); *DialAmerica*, 757 F.2d at 1385 ("[W]orkers are more likely to be 'employees' under the FLSA if they perform the primary work of the alleged employer.").

The Department is concerned that this focus on importance or centrality departs from the Supreme Court's original articulation of the economic reality test, has limited probative value regarding the ultimate question of economic dependence, and may be misleading in some instances. As such, proposed § 795.105(d)(2)(iii) would clarify that the "integral part" factor should instead consider "whether the work is part of an integrated unit of production," which aligns with the Supreme Court's analysis in *Rutherford Food*, 331 U.S. at 729. As explained earlier, the "integral part" factor was not one of the distinct factors identified in *Silk* as being "important for decision." 331 U.S. at 716.<sup>41</sup> Nor was the importance of the work discussed in *Rutherford Food* as one of the distinct considerations. Instead, *Rutherford Food* observed that the work at issue was "part of an integrated unit of production" in the potential employer's business and concluded that workers were employees in part because they "work[ed] alongside admitted employees of the plant operator at their tasks." 331 U.S. at 729. The 1947 proposed Treasury regulations under the Social Security Act articulated the sixth factor of the economic reality test in line with *Rutherford Food*'s "integrated unit" discussion as: "[i]ntegration of the individual's work in the businesses to which he renders services," which concerned "the merger of the individual's services into the businesses, so that such services constitute a part of the unity or whole which comprise such business." 12 FR at 7966–67.

<sup>41</sup> *Silk* did ask whether workers themselves were "an integral part of [defendants'] businesses," as opposed to operating their own businesses, but that question was presented as the ultimate economic reality inquiry, as opposed to a factor to be weighed in that analysis. 331 U.S. at 716.

The word "integral" can mean either very important or integrated.<sup>42</sup> As some courts recognize, a worker can perform services that are important to a business without being integrated, meaning merged, into that business's operations. *See, e.g., Green v. Premier Telecomm. Servs., LLC*, No. 1:16–CV–0332–LMM, 2017 WL 4863239, at \*14 (N.D. Ga. Aug. 15, 2017) ("While certainly Plaintiff performing his job was integral to Premier's bottom-line, unlike in *Rutherford*, Plaintiff did not perform one step in an integrated system."). Federal courts of appeals typically considered integration of worker into the potential employer's production process until the 1970s. *See, e.g., Driscoll*, 603 F.2d at 754 ("Appellants' activities appear to be an integral part of Driscoll's strawberry growing operation, rather than an independently viable enterprise."); *Mednick v. Albert Enterprises, Inc.*, 508 F.2d 297 (5th Cir. 1975) (asking whether the service "was [an integrated part of the business of [a potential employer] in the same way as the work of the meat boners in *Rutherford*."); *Tobin v. Anthony-Williams Mfg. Co.*, 196 F.2d 547, 550 (8th Cir. 1952) ("The haulers and woods workers here are such an integrated part of defendant's production.").<sup>43</sup> Starting in the 1980s, courts instead began to analyze whether the work is important to the potential employer. *See, e.g., Lauritzen*, 835 F.2d 1529, 1534–35; *DialAmerica Mktg.*, 757 F.2d at 1386.

Focusing on whether an individual's work is important to a potential employer has questionable probative value regarding the issue of economic dependence, and may even be counterproductive in some cases. Judge Easterbrook's *Lauritzen* concurrence argued that asking whether work is integral "has neither significance nor

<sup>42</sup> Compare, *e.g.*, Cambridge Dictionary, <https://dictionary.cambridge.org/us/dictionary/english/integral> (defining integral as "necessary and important") with Merriam-Webster Dictionary, <https://www.merriam-webster.com/dictionary/integral> (defining "integral" as "formed as a unit with another part"); *see also* Merriam Webster Pocket Dictionary 1947 (defining integral as either "Needed for completeness" or "Composed of parts that make up a whole").

<sup>43</sup> The Department has generally used "integral" rather than "integrated" in its subregulatory guidance since the 1950s. *See* WHD Opinion Letter (Aug. 13, 1954); WHD Opinion Letter (Feb. 8, 1956). A 2002 opinion letter interpreted the factor to focus on the importance of the work, explaining that "[w]hen workers play a crucial role in a company's operation, they are more likely to be employees than independent contractors." WHD Opinion Letter, 2002 WL 32406602, at \*3 (Sept. 5, 2002). However, the Department's most recent opinion letter on this subject characterized the factor as "the extent of the integration of the worker's services into the potential employer's business." WHD Opinion Letter FLSA2019–6 at 6 (emphasis added).

meaning” because “[e]verything the employer does is ‘integral’ to its business—why else do it?” 835 F.2d at 1541 (Easterbrook, J. concurring) (emphasis in original); see also *Zheng*, 355 F.3d at 73 (cautioning in the joint employer context that interpreting the factor to focus on importance “could be said to be implicated in every subcontracting relationship, because all subcontractors perform a function that a general contractor deems ‘integral’ to a product or a service”) (emphasis in original). Some courts have explained that “a worker who performs a routine task that is normal and integral to the putative employer’s business is likely to be dependent on the defendant’s overall enterprises.” *Beck v. Boce Grp., L.C.*, 391 F. Supp. 2d 1183, 1192 (S.D. Fla. 2005); see also *Charles v. Burton*, 169 F.3d 1322, 1332–33 (11th Cir. 1999) (same). This explanation, however, may be flawed: If certain workers perform tasks that are important to a business, the logical inference is that the business is dependent on those workers—not the reverse. Put differently, the relative importance of the worker’s task to the business of the potential employer says nothing about whether the worker economically depends on that business for work.

Other courts have explained that “it is presumed that, with respect to vital or integral parts of the business, the employer will prefer to engage an employee rather than an independent contractor. This is so because the employer retains control over the employee and can compel attendance at work on a consistent basis.” *Dataphase*, 781 F. Supp. at 735; see also *Barnard Const.*, 860 F. Supp. at 777, *aff’d sub nom. Baker v. Flint Eng’g & Const. Co.*, 137 F.3d 1436 (10th Cir. 1998) (same). But the control factor already directly analyzes whether a business can compel a worker to work on a consistent basis. See, e.g., *Nieman*, 775 F. App’x at 625 (“The first factor—control—weighs in favor of independent contractor status because Nieman . . . controlled his schedule.”). It is unclear why there is a need to indirectly analyze control by presuming a relationship between vital or integral services and control. Nor is it clear that such presumption survives scrutiny because businesses appear to routinely hire independent contractors over whom they exercise little control to perform vital or integral services.<sup>44</sup> Indeed, as transaction costs fall, as is the trend in

many sectors of the economy,<sup>45</sup> firms become more willing to hire independent contractors for vital or integral tasks, further diminishing the probative value of the importance of the work.

Focusing on the importance of work can sometimes send misleading signals regarding economic dependence. For instance, some courts have explained that “easily replaceable” workers are less integral to a business, and therefore, are less dependent on that business. *Browning v. Ceva Freight, LLC*, 885 F. Supp. 2d 590, 610 (E.D.N.Y. 2012); see also *Velu v. Velocity Exp., Inc.*, 666 F. Supp. 2d 300, 307 (E.D.N.Y. 2009) (observing that integrality to business diminished where “work is interchangeable with the work of other[s]”). But the workers in *Rutherford Food* were also “easily replaceable” precisely because they were “part of the integrated unit of production” of a slaughterhouse processing line, which in turn indicated they were employees. 331 U.S. at 729. More often than not, easily replaceable workers are more dependent on that business for work—not less. Thus, focusing on the worker’s importance to a business under the “integral part” factor may obscure rather than illuminate the ultimate economic dependence inquiry.

Finally, analyzing the importance of work under the “integral part” factor may send misleading signals due to the increasing difficulty of defining important or core functions of a growing number of intermediary companies whose main activity is “selling reductions in transaction costs.”<sup>46</sup> By one view, the core functions of a company that connects service providers to customers might be the service being provided. See *O’Connor v. Uber Techs., Inc.*, 82 F. Supp. 3d 1133, 1153 (N.D. Cal. 2015) (“[D]rivers perform a regular and integral part of Uber’s business[.]”). But in another view, such a company’s core services might be connecting service providers and customers.<sup>47</sup> See *Razak*, 951 F.3d at 147 n. 12 (“We also believe [there]

could be a disputed material fact” whether Uber is “a technology company that supports drivers’ transportation businesses, and not a transportation company that employs drivers.”). Under this view, the intermediary company’s “business operations effectively terminate at the point of connecting service providers to consumers and do not extend to the service provider’s actual provision of services.” WHD Opinion Letter FLSA2019–6 at 10. While intermediary companies are more prevalent in the virtual marketplace, they are not limited to that context.<sup>48</sup> For instance, health care brokers may be intermediaries that are in the business of connecting health care providers to health care consumers. See *State Dep’t of Employment, Training & Rehab., Employment Sec. Div. v. Reliable Health Care Servs. of S. Nevada, Inc.*, 983 P.2d 414, 419 (Nev. 1999) (“[W]e cannot ignore the simple fact that providing patient care and brokering workers are two distinct businesses.”).

Analyzing the importance of services to a potential employer often first requires characterizing the potential employer’s business as either an intermediary or a direct provider of services. But that characterization, in turn, requires answering the economic dependence question. If a potential employer is an intermediary company that merely connects service providers with customers, those service providers would have distinct businesses of their own. WHD Opinion Letter FLSA2019–6 at 10. As such, they would not be a part, let alone an essential or important part, of the potential employer’s business. Analyzing the importance of services to evaluate economic dependence thus becomes a circular exercise. The factor considers whether workers’ services are an important part of the potential employer’s business to answer the ultimate inquiry of whether workers provide services as part of their own distinct businesses. See *Silk*, 331 U.S. at 716 (asking whether workers were “an integral part of [defendants’] businesses,” as opposed to operating their own businesses, as the ultimate inquiry, rather than a discrete factor to be weighed).

For these reasons, proposed § 795.105(d)(2)(iii) would rearticulate the “integral part” factor in accordance with the Supreme Court’s original inquiry in *Rutherford Food* of whether the work was “part of the integrated unit of production,” with an emphasis

<sup>44</sup> See, e.g., L. Katz and A. Krueger, “The Rise and Nature of Alternative Work Arrangements in the United States, 1995–2015,” p. 25 (2018) (“Coase’s (1937) classic explanation for the boundary of firms rested on the minimization of transaction costs within firm-employee relationships. Technological changes may be reducing the transaction costs associated with contracting out job tasks, however, and thus supporting the disintermediation of work.”).

<sup>46</sup> See Michael Munger, Tomorrow 3.0: Transaction Costs and the Sharing Economy, 51 (2018).

<sup>47</sup> See *id.* at 61 (“The middleman makes possible transactions that otherwise could not take place . . . [by] selling transaction cost reduction[.]”).

<sup>48</sup> See *id.* at 125 (“The idea of a ‘gig economy’ is old, but the possibility of serial short term employment or ‘gigs’ are expanding rapidly” because “entrepreneurs have found [new] ways to sell reductions in transaction costs.”).

<sup>44</sup> See, e.g., *Iontchev*, 685 F. App’x at 551; *Meyer*, 607 F. App’x at 123; *Freund*, 185 F. App’x at 784; *Mid-Atl. Installation Servs., Inc.*, 16 F. App’x at 107.

that the factor is different from the concept of importance or centrality. Courts that have applied the “integral part” factor to analyze integration rather than importance have typically grounded this factor to the specific circumstances in *Rutherford Food*. The Second Circuit, for example, recognized in a joint employer case that this factor was derived from the Supreme Court’s focus on the fact that the *Rutherford Food* plaintiffs “did a specialty job on the production line,” and thus limited this factor’s application to the production line or an analogous context. *Zheng*, 355 F.3d at 73 (“[W]e construe *Rutherford* to mean that work on a production line occupies a special status under the FLSA[.]”); see also *Antenor v. D & S Farms*, 88 F.3d 925, 937 (11th Cir. 1996) (asking whether workers “were analogous to employees working at a particular position on a larger production line”); *Mednick*, 508 F.2d at 300 (analyzing whether the service “was [ ]an integrated part of the business of [a potential employer] in the same way as the work of the meat boners in *Rutherford*”); *Green*, 2017 WL 4863239, at \*14 (“[U]nlike in *Rutherford*, Plaintiff did not perform one step in an integrated system. He was not dependent on Premier’s overall process to execute his duties.”).

Proposed § 795.105(d)(2)(iii) thus focuses the “integrated unit” factor on whether an individual works in circumstances analogous to a production line. This factor weighs in favor of employee status where a worker is a component of a potential employer’s integrated production process, whether for goods or services. The overall production process need not be a physical assembly line, but it must be an integrated process that requires the coordinated function of interdependent subparts working towards a specific unified purpose.<sup>49</sup> This may occur where the worker depends on the overall process to perform work duties, such as, for example, a programmer who works on a software development team. See *Antenor*, 88 F.3d at 937 (finding farmworkers “were dependent on the growers’ overall production process”). Another example would be where an individual works closely alongside conceded employees and performs identical or closely interrelated tasks as those employees, such as where an individual provides office cleaning services as part of a team of employees.

Conversely, if the individual’s work is not integrated into the potential employer’s production process, the factor would favor classification as an independent contractor. This includes where an individual service provider is able to perform his or her duties without depending on the potential employer’s production process. *Green*, 2017 WL 4863239, at \*14 (“[U]nlike in *Rutherford*, [residential cable installer] . . . was not dependent on Premier’s overall process to execute his duties.”). Thus, performance of discrete, segregable services for individual customers is not part of an integrated unit of production. See WHD Opinion Letter FLSA 2019–6 at 11 (concluding that the workers who provide services to the virtual marketplace company’s individual customers “are not integrated into [the company]’s referral business”). The Department welcomes comments on this approach to the “integrated unit” factor.

The Department considered removing the “integral part” factor instead of rearticulating it as the above-described “integrated unit” factor, in part, out of concern that the “integrated unit” factor may have limited applicability in the modern economy. However, the Department believes that the “integrated unit” factor described above would be applicable in sufficient cases to warrant its listing as an economic reality factor. The Department also welcomes comments on this alternative approach to remove this factor and instead focus the economic reality test on four factors.

#### 6. Affording Greater Weight to the Two Core Factors

Proposed § 795.105(c) explains that the two core factors—*i.e.*, control and opportunity for profit or loss—are each afforded more weight in the analysis of economic dependence than are any of the others. As a result of their greater weight, if both core factors point towards the same classification, their combined weight is substantially likely to outweigh the combined weight of other factors that may point towards the opposite classification. In other words, where the two core factors align, the bulk of the analysis is complete. Anyone who is assessing the classification—whether a business, a worker, the Department, a court, or a jury—may approach the remaining factors and circumstances with skepticism, as only in unusual cases may such considerations outweigh the combination of the two core factors. At the same time, if the two core factors do not point toward the same classification, the remaining enumerated factors will usually determine the correct

classification. The discussion below explains in greater detail why Department’s proposes to focus the economic reality test on the two core factors in § 795.105(d)(1) over the other factors listed in § 795.105(d)(2) and any additional factors that may be considered.

The Department proposes a focus on the two core factors in light of the sharpened articulation of economic dependence in proposed § 795.105(b). The Supreme Court cautioned that control is not the sole consideration, see *Rutherford Food*, 331 U.S. at 730, but it did not deny that factor’s significance in the analysis. Indeed, the Court recognized that, “[o]bviously control is characteristically associated with the employer-employee relationship,” *Bartels*, 332 U.S. at 130. And the opportunity for profit and loss factor is more closely tied to the concept of economic dependence than any other factors because it is a necessary component of being in business for oneself. As the D.C. Circuit observed in an NLRA case, “‘significant entrepreneurial opportunity for gain or loss’ . . . [even] better captures the distinction between an employee and an independent contractor” than control. *Corporate Exp. Delivery Sys. v. NLRB*, 292 F.3d 777, 780 (2002); see also *FedEx Home Delivery*, 563 F.3d at 497. Together, these two factors shape the economic dependence inquiry of “whether the individual is, as a matter of economic reality, in business for himself.” *Parrish*, 917 F.3d at 379. In ordinary circumstances, an individual “who is in business for him- or herself” will have meaningful control over the work performed and a meaningful opportunity to profit (or risk loss). In sum, it is not possible to properly assess whether workers are in business for themselves or are instead dependent on another’s business without analyzing their control over the work and profit or loss opportunities.

While the Supreme Court established a multifactor approach to the question of employee versus independent contractor status, it did not require all factors to be treated equally. To the contrary, focusing on the control and opportunity for profit or loss factors is supported by the reasoning in *Silk*, 331 U.S. at 316, and *Whitaker House*, 366 U.S. at 32–33, the latter of which is the only post-*Rutherford Food* Supreme Court decision analyzing whether workers were employees or independent contractors under the FLSA. *Silk* held that coal unloaders were employees in the SSA context based on their lack of meaningful opportunity for profit or loss, and further recognized that the

<sup>49</sup> The unified purpose must be defined with specificity and thus would not include general business objectives such as increasing profits, cutting costs, or satisfying customer’s needs.

lack of permanence was not significant. 331 U.S. at 317–18. The Court further held that truck drivers in that case were independent contractors because of “the control [they] exercised [and] the opportunity for profit from sound management,” without discussing any of the other economic reality factors. *Id.* at 319.

In *Whitaker House*, the Court concluded that homeworkers who were paid on a piece-rate basis to produce knitted goods were employees, as opposed to being “self-employed” or “independent.” 366 U.S. at 32–33. While the Court reaffirmed that “‘economic reality’ rather than ‘technical concepts’ is to be the test for employment,” *id.* at 33 (citing *Silk*, 331 U.S. at 713, and *Rutherford Food*, 331 U.S. at 729), it did not analyze any of the specific factors that are part of the current economic reality test. Instead, the *Whitaker House* Court’s conclusion was based on the facts that the homeworkers could not “sell[] their products on the market for whatever price they can command” and were instead “regimented under one organization, manufacturing what the organization desires and receiving the compensation the organization dictates.” *Id.* at 32. In other words, the Supreme Court’s reasoning was based entirely on facts that related to control (“regimented under one organization, manufacturing what the organization desires”) and opportunity for profit (“selling their products on the market for whatever price they can command” versus “receiving the [piece rate] compensation the organization dictates”). The Court did not analyze any facts related to the workers’ skill, capital investment, permanence of relationship, or integration of the work to the business.

Focusing on control and opportunity for profit or loss is further supported by the results of federal courts of appeals cases weighing the economic reality factors since 1975. In these cases, whenever the court found (or affirmed a district court finding) that the potential employer predominantly controlled the work, that court concluded that the worker is an employee. *See, e.g., Hobbs*, 946 F.3d at 830–36; *Verma*, 937 F.3d at 230–32; *Gayle v. Harry’s Nurses Registry, Inc.*, 594 F. App’x 714, 717–18 (2d Cir. 2014); *Schultz v. Capital Int’l Sec., Inc.*, 466 F.3d 298, 307–09 (4th Cir. 2006); *Baker*, 137 F.3d at 1440–44; *Martin*, 949 F.2d at 1289. Conversely, whenever the court of appeals found (or affirmed a district court finding) that the worker predominantly controlled the work, that court nearly always concluded that the

worker is an independent contractor. *See, e.g., Parrish*, 917 F.3d at 379–388; *Nieman*, 775 F. App’x at 624–25 (per curiam); *Saleem*, 854 F.3d at 140–48; *Iontchev*, 685 F. App’x at 550–51; *Barlow v. C.R. England, Inc.*, 703 F.3d 497, 506–07 (10th Cir. 2012); *Mid-Atl. Installation Servs.*, 16 F. App’x at 106–08.

The few occasions where an appellate court’s ruling on a worker’s classification was contrary to what the control factor indicated were cases in which the other core factor—opportunity for profit or loss—pointed in the opposite direction. For example, in *Acosta v. Paragon Contractors Corporation*, the Tenth Circuit held that the control factor “indicates status as an independent contractor” because the defendant “could set his own hours and determine how best to perform his job within broad parameters.” 884 F.3d 1225, 1235–36 (10th Cir. 2018). The court nonetheless held that he was an employee, in part, because he “was paid only a flat fee” and therefore “could not increase or decrease his profits based on how well he did his job.” *Id.* at 1236; *see also Cromwell*, 348 F. App’x at 61 (concluding that the workers were employees even though they “controlled the details of how they performed their work [and] were not closely supervised” because, in part, defendant’s “complete control over [their] schedule and pay[] had the effect of severely limiting any opportunity for profit or loss”).

This trend is also true, indeed even more so, for the opportunity for profit or loss factor. Since 1975, virtually every time a circuit court of appeals has found (or affirmed a district court finding) that the potential employer predominantly determined the opportunities for profit or loss, the court has concluded that the worker was an employee. *See, e.g., Hobbs*, 946 F.3d at 832–36; *Off Duty Police*, 915 F.3d at 1059–1062; *McFeeley*, 825 F.3d at 243–44; *Hopkins*, 545 F.3d at 344–46; *Baker*, 137 F.3d at 1441–44; *Snell*, 875 F.2d at 808–812; *Superior Care*, 840 F.2d at 1059–61. Conversely, if the court found (or affirmed a district court finding) that the worker predominantly determined the opportunities for profit or loss, the court concluded that the worker was an independent contractor. *See, e.g., Parrish*, 917 F.3d at 384–88; *Saleem*, 854 F.3d at 140–48; *Iontchev*, 685 F. App’x at 550–51; *Freund*, 185 F. App’x at 783–84; *Eberline v. Media Net, L.L.C.*, 636 F. App’x 225, 228–29 (5th Cir. 2016); *Mid-Atl. Installation Servs.*, 16 F. App’x at 106–08. The opportunity for profit or loss factor as proposed in this rulemaking should be even more probative than these cases indicate

because it would incorporate the probative value of the facts regarding investment.<sup>50</sup>

In summary, each of the two core factors is, by itself, highly probative of a worker’s economic dependence. Together, *i.e.*, in cases where they both indicate the same classification, they are substantially likely to point to the answer of the classification question—whether employee or independent contractor.

The Department’s proposal is consistent with case law and adopting a more focused approach. Many courts have analyzed all six factors (or five depending on the circuit) on a factor-by-factor basis, even where some factors were recognized as having limited relevance in a particular context. *See, e.g., Hobbs*, 946 F.3d at 830–36; *Off Duty Police*, 915 F.3d at 1055–1062; *Nieman*, 775 F. App’x at 624–25; *Verma*, 937 F.3d at 230–32; *Snell*, 875 F.2d at 805–12; *Lauritzen*, 835 F.2d at 1535–38; *Mr. W Fireworks*, 814 F.2d at 1047–55; *DialAmerica*, 757 F.2d at 1382–88; *Donovan v. Sureway Cleaners*, 656 F.2d 1368, 1370–73 (9th Cir. 1981). Several recent court opinions focus their analysis on just the most relevant facts and factors to the case, thereby achieving efficiency and clarity. In each such opinion, the most relevant factors on which the court focused its attention were control and opportunity for profit or loss. And to the extent that the court considered elements of investment and initiative, such elements are part of the control and opportunity for profit or loss factors under the Department’s proposal.

In *Saleem*, the Second Circuit did not engage in the same factor-by-factor analysis as did the district court

<sup>50</sup> Even if the Department were to keep opportunity for profit or loss and investment as separate factors, the opportunity for profit or loss factor would still be of primary importance. In the above cited cases, the opportunity for profit or loss factor aligned with the overall result of the case even where that factor did not explicitly include consideration of the worker’s investment. A separate investment factor, however, would not be a core factor because its importance is secondary compared to opportunity for profit or loss. Federal courts of appeals have repeatedly concluded that workers without meaningful investment in a business are nonetheless independent contractors if they have meaningful opportunity for profit or loss based on their initiative or business acumen. *See, e.g., Parrish*, 917 F.3d at 382–85; *Meyer*, 607 F. App’x at 123; *Express Sixty-Minutes*, 161 F.3d at 303–04. Conversely, where the investment factor favors independent contractor classification to some degree, workers may nonetheless be employees if they lack such opportunity. *See Cromwell*, 348 F. App’x at 61. Thus, if opportunity for profit or loss and investment were kept as separate factors in a final rule, the Department would propose making opportunity for profit or loss a core factor and investment a non-core factor. The Department welcomes comments on this alternative approach.

regarding the black-car drivers, noting the economic reality “factors are merely aids to analysis.” 854 F.3d at 138–39. Instead, the court focused on the drivers’ “considerable discretion in choosing the nature and parameters of their relationship with the defendant,” “significant control over essential determinants of profits in [the] business,” how they “invested heavily in their driving businesses,” and the “ability to choose how much work to perform,” to conclude that they were “in business for themselves” as independent contractors. *Id.* at 139–47. In other words, *Saleem* primarily analyzed facts pertaining to the drivers’ control over their work and opportunity for profit or loss based on initiative or investment, the core factors under this proposed rule. In particular, the Second Circuit explicitly questioned the relevance of the permanence factor in light of the control factor, observing that “whatever ‘the permanence or duration’ of Plaintiffs’ affiliation with Defendants, both its length and the ‘regularity’ of work was entirely of Plaintiffs’ choosing,” *id.* at 147 (citation omitted), and gave no consideration whatsoever to the district court’s findings, 52 F. Supp. 3d 526, 543 (S.D.N.Y. 2014), “that driving is not a ‘specialized skill’ and that ‘drivers were integral to Defendants’ business.’”

The Second Circuit again focused on control and opportunity for profit or loss in *Agerbrink v. Model Service LLC* by relying on several disputed material facts (“control over her work schedule, whether she had the ability to negotiate her pay rate, and, relatedly, her ability to accept or decline work”) relating to those two factors to vacate summary judgment. 787 F. App’x 22, 25–27 (2d Cir. 2019). The Third Circuit took a similar approach in *Razak v. Uber Technologies, Inc.*, which held that summary judgment was inappropriate because there were genuine disputes of fact regarding “whether Uber exercises control over drivers” and whether drivers have “the opportunity for profit or loss depending on managerial skill.” 951 F.3d at 145–47.<sup>51</sup> And the Eighth

Circuit recently affirmed a jury verdict that a process server was an independent contractor, relying primarily on evidence relating to the control and opportunity for profit or loss factors, including the process server’s ability to determine his own profits by controlling hours, which assignments to take, and for which company to work. *See Karlson*, 860 F.3d at 1095.

In summary, control and opportunity for profit or loss drive at the heart of what it means to be an independent contractor who is in business for oneself and are the most relevant factors in virtually every case. As such, the Department believes focusing on these two as the core factors would add much needed clarity and efficiency to the economic reality test. The Department welcomes comments on this approach, which departs from courts’ and Department’s previous practice of not expressly identifying which types of facts or factors are the most important.

#### 7. The Other Factors

In contrast to the two core factors, the other factors listed in § 795.105(d)(2) relating to skill, permanence, and integration are not always as probative to an inquiry into whether a worker is, as a matter of economic reality, in business for him- or herself or economically dependent on someone else for work. Rather, their relevance varies depending on the circumstances. Moreover, relevant aspects of the skill and permanence factors under the current test—*i.e.*, initiative and exclusivity, respectively—are already part of the analysis with respect to the core factors. Since this rulemaking would remove such confusing overlaps by removing initiative and exclusivity from the skill and permanence factors, respectively, the probative value of these two factors would become even more limited.

**Skill factor.** To be sure, some independent contractors in business for themselves have “some unique skill set[s].” *Parrish*, 917 F.3d at 385. But many skills that count towards this factor are not necessarily relevant to the question of economic dependence. In *Scantland*, for instance, the Eleventh Circuit reasoned that the skill factor weakly favored independent contractor status in part because “a highly trained technician could gain economic independence by the ability to market his skills to a competing employer.” *Scantland*, 721 at 1318. But “the ability to market oneself to a competing

employer,” without more, does not help answer the ultimate question the *Scantland* court was attempting to answer: “whether an individual is in business for himself or is dependent upon finding employment in the business of others.” *Id.* at 1312 (emphasis added).

Thus, the skill factor is over-inclusive to the extent it includes skills that may merely enable a worker to find employment, but do not indicate the worker is in business for him- or herself. Recognizing this over-inclusiveness issue, some courts have explained that “the use of special skills is not itself indicative of independent contractor status, especially if the workers do not use those skills in any independent way.” *Selker Bros.*, 949 F.2d at 1295; *see also Superior Care*, 840 F.2d at 1060. As discussed above, these courts made the worker’s capacity for initiative, a consideration under the control factor in the Department’s proposal, the most important aspect of the skill factor. This proposed rule would remove initiative as a consideration under the skill factor. Because capacity for initiative is already a part of the control factor and the effect of initiative is already a part of the opportunity for profit or loss factor, these changes would thus cement the secondary importance of the skill factor.

The skill factor is also under-inclusive because it excludes certain managerial and business skills that are highly probative as to economic dependence. *See Hopkins*, 545 F.3d at 345 (“Certainly, the Sales Leaders required a general set of skills to effectively manage their offices and teams. However, these are not specialized skills; they are abilities common to *all* effective managers.”). A pair of cases involving drivers are illustrative in this regard. In *Express Sixty-Minutes Delivery*, the Fifth Circuit recognized that a delivery driver “must rely on his own judgment, knowledge of traffic patterns and road conditions . . . , ability to read [mapping software], and ability to anticipate the need for an alternative route.” 161 F.3d at 304. However, these did not constitute skill indicating independent contractor status. *See id.* at 305 (“We agree with the Secretary that the skill and initiative factor points toward employee status.”). Nonetheless, the court ultimately found the drivers were independent contractors, in part, because “a driver’s profit or loss is determined largely on his or her skill, initiative, ability to cut costs, and understanding of the courier business.” *Id.* at 304. In other words, the skill factor expressly excluded the precise attributes that gave drivers an opportunity for profit, thereby

<sup>51</sup> The *Razak* court also found a genuine dispute regarding degree of permanence of the working relationship, but characterized that dispute in one sentence solely as an issue of control, as opposed to permanence of the relationship: “On one hand, Uber can take drivers offline, and on the other hand, Plaintiffs can drive whenever they choose to turn on the Driver App, with no minimum amount of driving time required.” 951 F.3d at 147. In addition, the court agreed with the district court that the skill factor “certainly weighs in favor of finding that Plaintiffs are employees.” *Id.* Finally, the court acknowledged in a footnote that “Uber strenuously disputes” the district court’s finding that the “integral” factor weighed in favor of employee status and indicated that there could be

disputed material facts relating to this factor. *Id.* at n.12.



indicating their independent contractor status. *Id.* A similar omission occurred in *Iontchev*, a case in which the Ninth Circuit concluded that certain taxi drivers were independent contractors in part because the “[d]rivers’ opportunity for profit or loss depended upon their managerial skill.” 685 F. App’x at 550. But such managerial skill evidently did not count towards the skill factor because the court concluded that “[t]he service rendered by the Drivers did not require a special skill.” *Id.*

The Department’s proposal to deemphasize the skill factor as compared to the core factors is supported by the statutory text and case law. Employers can “suffer and permit” both skilled and non-skilled individuals to perform work as employees, 29 U.S.C. 203(g), and federal courts of appeals have routinely held that the presence of specialized skill does not mean a worker is an independent contractor if the worker lacks control over the work, an opportunity for profit or loss, or both. *See, e.g., Cromwell*, 348 F. App’x at 60 (telecom splicers); *Superior Care*, 840 F.2d at 1060 (nurses). Nor does the absence of specialized skill mean a worker is an employee if the worker otherwise has control over the work and an opportunity for profit or loss. *See, e.g., Express Sixty-Minutes Delivery*, 161 F.3d at 304 (delivery workers); *Iontchev*, 685 F. App’x at 550 (taxi drivers).

**Permanence factor.** Under the current test, this factor concerns the exclusivity and length of the relationship between the worker and the potential employer. If this rule were finalized as proposed, exclusivity of the relationship would be analyzed under the control factor rather than the permanence factor to reduce confusing overlap between factors. The permanence factor would consider the duration, continuity, and regularity of the relationship.<sup>52</sup>

The Department believes that the remaining considerations that are part of this factor—duration, continuity, and regularity—are relevant to an economic reality analysis, though less so than the core factors. Specifically, the length of relationship between a worker and a potential employer has less relevance to the issue of economic dependence than the core factors. To be sure, many independent contractors who are in business for themselves lack a long-term relationship with a single client because

they work on “a project-by-project basis.” *See, e.g., Parrish* 917 F.3d at 387. But that does not mean independent contractors cannot have long-term working relationships. To the contrary, the existence of a long-term relationship has not prevented courts from finding workers to be independent contractors, particularly when such workers control their work and enjoy opportunities for profit or loss. *See, e.g., Iontchev*, 685 Fed. App’x at 550–51 (concluding that “Drivers were not economically dependent upon AAA Cab” even though “[t]he working relationship was often lengthy”); *Eberline*, 636 F. App’x at 229 (concluding that installers were independent contractors even though “the length of the relationship between the Defendants and the installers was indefinite” and “no reasonable jury could have concluded that [the permanence] factor favored independent contractor status”); *DialAmerica*, 757 F.2d at 1387 (concluding that “distributors were not employees under the FLSA because they operated more like independent contractors” even though “many distributors did perform delivery work for DialAmerica continuously for several years”).

Nor does the absence of a long-term working relationship preclude a finding of employee status. Workers who move from job to job or work for short periods of time can still be economically dependent on an employer. As the Second Circuit observed in *Superior Care*, “even where work forces are transient, the workers have been deemed employees where the lack of permanence is due to operational characteristics intrinsic to the industry rather than to the workers’ own business initiative.” 840 F.2d at 1060–61. It is therefore unsurprising that federal courts of appeals have held that workers who lack a permanent relationship with a potential employer are nonetheless economically dependent if the worker lacked control over the work and an opportunity for profit or loss. *See, e.g., Verma*, 937 F.3d at 230–32; *Reich v. Circle C. Investments, Inc.*, 998 F.2d 324, 327–29 (5th Cir. 1993); *Superior Care*, 840 F.2d at 1060–61. Because it is often trumped by the core factors, the proposed regulation gives less weight to the permanence of the relationship.

**Integrated unit factor.** As discussed above, the applicability of the “integrated unit” factor in proposed § 795.105(d)(2)(iii) is limited to the instances where a potential employer has an integrated production process (including a service business). Given this limited applicability, the Department believes the integrated unit

factor is entitled to less weight than the core factors.

In sum, the two core factors drive at the heart of the economic dependence question because they bear a causal relationship with the ultimate inquiry. A worker’s control over the work and the opportunity for profit or loss are generally what transforms him or her from being economically dependent on an employer as a matter of economic reality into being in business for him- or herself. This is not so with the other factors. Possessing a specialized skill, having a temporary working relationship, and not being part of an integrated unit of production are certainly characteristics shared by many workers who are in business for themselves. But they are often indicators rather than essential elements of being in business for oneself.

Accordingly, the Department proposes to focus the economic reality test on the two core factors. Instead of balancing six or so unweighted and overlapping factors, a worker’s classification as an employee or independent contractor can be largely determined in many cases by two simple questions: (1) Does the worker exercise substantial control over the key aspects of the work; and (2) does the worker have an opportunity for profit or a risk of loss based on initiative or investment? If the answer to both is “yes,” the worker is most likely an independent contractor. And if the answer to both is “no,” the worker is most likely an employee. Other factors may also be probative as part of the circumstances of the whole activity, but are less important. They are especially relevant when the two core factors do not point in the same direction or do not point strongly in either direction. The Department believes this proposed approach would improve the clarity and predictability of the economic reality test.

In the course of formulating this NPRM, the Department also considered a more structured approach to sharpening the economic reality test under the FLSA. In particular, the Department considered creating a presumption of employee or independent contractor status where both core factors indicate the same status. Such a presumption would be rebuttable only by a showing that other factors weighed strongly in favor of the other outcome. The Department is concerned that this approach would be confusing or burdensome on courts and the regulated community. Accordingly, the Department is not proposing a presumption-based approach at this time, but is nonetheless interested in

<sup>52</sup> Even if the Department were to retain the analysis of exclusivity under a newly named “permanence and exclusivity” factor, that factor would be of secondary importance. This is because the most important part of the “permanence and exclusivity” factor, *i.e.*, exclusivity, would add no additional probative value on top of what is already provided by the control factor.



comments on this, or other possible approaches to the economic reality test.

#### *E. Proposed Guidance Regarding the Primacy of Actual Practice*

Proposed § 795.110 states that the actual practice of the parties involved—both of the worker (or workers) at issue and of the potential employer—is more relevant than what may be contractually or theoretically possible. This principle is derived from the Supreme Court's holding that “‘economic reality’ rather than ‘technical concepts’ is to be the test of employment” under the FLSA. *Whitaker House*, 366 U.S. at 33; *see also Tony & Susan Alamo*, 471 U.S. at 301 (“The test of employment under the [FLSA] is one of ‘economic reality’” (citing *Whitaker House*, 366 U.S. at 33)). Applying this guidance, federal courts of appeals have emphasized the primacy of actual practice when evaluating whether workers are employees or independent contractors under the FLSA. *See, e.g., Saleem*, 854 F.3d at 142 (“[P]ursuant to the economic reality test, it is not what [Plaintiffs] could have done that counts, but as a matter of economic reality what they actually do that is dispositive.”) (citations omitted); *Parrish*, 917 F.3d at 387 (“The analysis is focused on economic reality, not economic hypotheticals.”); *Scantland*, 721 F.3d at 1311 (“It is not significant how one ‘could have’ acted under the contract terms. The controlling economic realities are reflected by the way one actually acts.”) (citations omitted).

As the examples in proposed § 795.110 illustrate, the primacy of the parties’ actual practice applies to every potentially relevant factor, and it can weigh in favor of either an employee or independent contractor relationship. In some cases, the actual practice of the parties involved may suggest that the worker or workers are employees. *See, e.g., Sureway Cleaners*, 656 F.2d at 1371 (“[T]he fact that Sureway’s ‘agents’ possess, in theory, the power to set prices, determine their own hours, and advertise to a limited extent on their own is overshadowed by the fact that in reality the ‘agents’ work the same hours, charge the same prices, and rely in the main on Sureway for advertising.”); *DialAmerica*, 757 F.2d at 1387 (concluding that evidence showing workers were not doing similar work for any other businesses “although they were free to do so” indicates employee status). In other cases, it may suggest that the worker or workers at issue are independent contractors. *See Saleem*, 854 F.3d at 143 (concluding that black-car drivers were independent contractors in part because “many

Plaintiffs . . . picked up passengers via street hail, despite TLC’s (apparently under-enforced) prohibition of this practice”); *see also Bartels*, 332 U.S. at 129 (rejecting in an SSA case the argument that employee status under an economic reality test could “be determined solely by the idea of control which an alleged employer *may* or *could* exercise over the details of the service rendered to his business by the worker or workers”) (emphasis added).

Importantly, proposed § 795.110 does not suggest that what is contractually or theoretically possible in a work arrangement is irrelevant. Contractual and theoretical possibilities are also part of the economic reality of the parties’ relationship, and excluding them outright would not be consistent with the Supreme Court’s instruction in *Rutherford Food* to evaluate “the circumstances of the whole activity.” 331 U.S. at 730; *see also Mid-Atlantic Installation Servs.*, 16 F. App’x at 107 (determining that cable installers were independent contractors in part because they had a “right to employ [their own] workers”); *Keller*, 781 F.3d at 813 (citing as relevant “the fact that Miri never explicitly prohibited Keller from performing installation services for other companies” and finding “a material dispute as to whether Keller could have increased his profitability had he improved his efficiency or requested more assignments”). Contractual or theoretical possibilities are less relevant evidence to the employment status inquiry, but the Department believes they are potentially relevant nonetheless.

#### *F. Severability*

Finally, the Department proposes to include a severability provision in part 795 so that, if one or more of the provisions of part 795 is held invalid or stayed pending further agency action, the remaining provisions would remain effective and operative. The Department proposes to add this provision as § 795.115.

#### **V. Paperwork Reduction Act**

The Paperwork Reduction Act of 1995 (PRA), 44 U.S.C. 3501 *et seq.*, and its attendant regulations, 5 CFR part 1320, require the Department to consider the agency’s need for its information collections, their practical utility, as well as the impact of paperwork and other information collection burdens imposed on the public, and how to minimize those burdens. The PRA typically requires an agency to provide notice and seek public comments on any proposed collection of information contained in a proposed rule. *See* 44

U.S.C. 3506(c)(2)(B); 5 CFR 1320.8. This NPRM does not contain a collection of information subject to OMB approval under the Paperwork Reduction Act. The Department welcomes comments on this determination.

#### **VI. Executive Order 12866, Regulatory Planning and Review; and Executive Order 13563, Improved Regulation and Regulatory Review**

##### *A. Introduction*

Under E.O. 12866, OMB’s Office of Information and Regulatory Affairs determines whether a regulatory action is significant and, therefore, subject to the requirements of the Executive Order and OMB review.<sup>53</sup> Section 3(f) of Executive Order 12866 defines a “significant regulatory action” as an action that is likely to result in a rule that: (1) Has an annual effect on the economy of \$100 million or more, or adversely affects in a material way a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local or tribal governments or communities (also referred to as economically significant); (2) creates serious inconsistency or otherwise interferes with an action taken or planned by another agency; (3) materially alters the budgetary impacts of entitlement grants, user fees, or loan programs, or the rights and obligations of recipients thereof; or (4) raises novel legal or policy issues arising out of legal mandates, the President’s priorities, or the principles set forth in the Executive Order. Because the annual effect of this proposed rule would be greater than \$100 million, this proposed rule would be economically significant under section 3(f) of Executive Order 12866.<sup>54</sup>

Executive Order 13563 directs agencies to propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs; that it is tailored to impose the least burden on society, consistent with achieving the regulatory objectives; and that, in choosing among alternative regulatory approaches, the agency has selected the approaches that maximize net benefits. Executive Order 13563 recognizes that some benefits are difficult to quantify and provides that, when appropriate and permitted by law, agencies may consider and discuss qualitatively values that are difficult or

<sup>53</sup> *See* 58 FR 51735 (Sept. 30, 1993).

<sup>54</sup> The entirety of the estimated costs from this deregulatory action, which exceed the \$100 million threshold and relate strictly to familiarization, fall in the first year alone. The Department’s Regulatory Impact Analysis further explains that these one-year costs are more than offset by continuing annual cost-savings of \$447 million per year, accruing to the same parties that face the familiarization costs.

impossible to quantify, including equity, human dignity, fairness, and distributive impacts.

#### B. Overview of Analysis

The Department estimates there were 10.6 million workers who worked at any given time as independent contractors as their primary jobs in the United States in 2017 (6.9 percent of all workers), the most recent year of data available. Including independent contracting on secondary jobs results in an estimate of 18.9 million independent contractors (12.3 percent of all workers). The Department discusses other studies providing estimates of the total number of independent contractors, ranging from 6.1 percent to 14.1 percent of workers (see Table 3 in VI.C.2). Due to uncertainties regarding magnitude and other factors, the Department has not quantified the potential change to the

aggregate number of independent contractors that may occur if this proposed rule is finalized. Furthermore, the Department's analysis relies on data collected prior to 2020, which reflects the state of the economy prior to the COVID-19 pandemic. The Department acknowledges that data on independent contractors could look different following the economic effects of the pandemic, but does not yet have information to determine how the number of independent contractors could change nor whether these changes would be lasting or a near term market distortion. The Department invites comments from stakeholders on the data used in this analysis and on how the universe of independent contractors might change as a result of this proposed rule. Specifically, the Department requests data and comment

on the possible impacts resulting from the COVID-19 pandemic as it relates to the composition of the labor market, the share and scope of independent contractors in the workforce, and any associated wage effects.

The Department estimated regulatory familiarization costs to be \$370.9 million in the first year. The Department estimated cost savings due to increased clarity to be \$447.2 million per year, and cost savings due to reduced litigation to be \$33.6 million per year. This results in a 10-year annualized net cost savings of \$374.8 million using a 3 percent discount rate and \$369.0 million using a 7 percent discount rate.<sup>55</sup> For purposes of E.O. 13771, the annualized net cost savings over a perpetual time horizon are \$221.3 million.<sup>56</sup> Other costs, benefits, and cost savings are discussed qualitatively.

TABLE 3—SUMMARY OF ESTIMATES OF INDEPENDENT CONTRACTING

Impact	Year 1	Year 2	Year 10	Annualized values <sup>a</sup>	
				7% Discount	3% Discount
Regulatory Familiarization Costs (\$2019 millions)					
Establishments .....	\$152.3	\$0.0	\$0.0	\$21.7	\$17.9
Independent Contractors .....	218.6	0.0	0.0	31.1	25.6
Total .....	370.9	0.0	0.0	52.8	43.5
Increased Clarity Cost Savings (\$2019 millions)					
Employers .....	369.0	369.0	369.0	369.0	369.0
Independent Contractors .....	78.1	78.1	78.1	78.1	78.1
Total .....	<sup>b</sup> 447.2	447.2	447.2	447.2	447.2
Reduced Litigation Cost Savings (\$2019 millions)					
	33.6	33.6	33.6	33.6	33.6
Total Cost Savings (\$2019 millions)					
	480.8	480.8	480.8	480.8	480.8
Net Cost Savings (Cost Savings – Costs) (\$2019 millions)					
	109.9	480.8	480.8	369.0	374.8

<sup>a</sup> Annualized over 10-years.

<sup>b</sup> The numbers in this table do not sum to the total exactly because of rounding. Please see Table 4 for unrounded values.

#### C. Independent Contractors: Size and Demographics

##### 1. Current Number of Independent Contractors

The Department estimated the number of independent contractors to provide a sense of the current size of this population. There are a variety of estimates of the number of independent

contractors and these span a wide range based on methodologies and how the population is defined. The Department believes that the Current Population Survey (CPS) Contingent Worker Supplement (CWS) offers an appropriate lower bound for the number of independent contractors; however, there are potential biases in these data that will be noted. Additionally, estimates

from other sources will be presented to demonstrate the potential range.

The CPS is conducted by the U.S. Census Bureau and published monthly by the Bureau of Labor Statistics (BLS). The sample includes approximately 60,000 households and is nationally representative. Periodically since 1995, and most recently in 2017, the CPS has included a supplement to the May

<sup>55</sup> Discount rates are directed by OMB. See Circular A-4, OMB (Sept. 17, 2003).

<sup>56</sup> Per OMB guidelines, E.O. 13771 data is represented in 2016 dollars, inflation-adjusted for when the proposed rule would take effect.

survey to collect data on contingent and alternative employment arrangements. Based on the CWS, there are 10.6 million independent contractors, which amounts to 6.9 percent of workers.<sup>57</sup> The CWS measures those who say that their independent contractor job is their primary job and that they worked at the independent contractor job in the survey's reference week. It is an important data set and analysis. However, based on the survey's design, while the Department refers to the CWS measure of independent contractors throughout this analysis, it should be uniformly recognized as representing a constrained subsection of the entire independent contractor pool. Due to its clear methodological constraints, the CWS measure should be differentiated from other, more comprehensive measures.

The BLS's estimate of independent contractors includes "[w]orkers who are identified as independent contractors, independent consultants, or freelance workers, regardless of whether they are self-employed or wage and salary workers." BLS asks two questions to identify independent contractors:<sup>58</sup>

- Workers reporting that they are self-employed are asked: "Are you self-employed as an independent contractor, independent consultant, freelance worker, or something else (such as a shop or restaurant owner)?" (9.0 million independent contractors). We refer to these workers as "self-employed independent contractors" in the remainder of the analysis.

- Workers reporting that they are wage and salary workers are asked: "Last week, were you working as an independent contractor, an independent consultant, or a freelance worker? That is, someone who obtains customers on their own to provide a product or service." (1.6 million independent contractors). We refer to these workers as "other independent contractors" in the remainder of the analysis.

It is important to note that independent contractors are identified in the CWS in the context of the respondent's "main" job (*i.e.*, the job with the most hours).<sup>59</sup> Therefore, the

estimate of independent contractors does not include those who may be defined as an employee for their primary job, but may work as an independent contractor for a secondary or tertiary job.<sup>60</sup> For example, Lim et al. (2019) estimate that independent contracting work is the primary source of income for 48 percent of independent contractors.<sup>61</sup> Applying this estimate to the 10.6 million independent contractors estimated from the CWS, results in 22.1 million independent contractors (10.6 million ÷ 0.48). Alternatively, a survey of independent contractors in Washington found that 68 percent of respondents reported that independent contract work was their primary source of income.<sup>62</sup> Applying that estimate to the 10.6 million independent contractors from the CWS results in an estimated 15.6 million independent contractors (10.6 million ÷ 0.68).

The CWS's large sample size results in small sampling error. However, the questionnaire's design may result in some non-sampling error. For example, one potential source of bias is that the CWS only considers independent contractors during a single point in time—the survey week (generally the week prior to the interview).

These numbers will thus underestimate the prevalence of independent contracting over a longer timeframe, which may better capture the size of the population.<sup>63</sup> For example,

<sup>60</sup> Even among independent contractors, failure to report multiple jobs in response to survey questions is common. For example, Katz and Krueger (2019) asked Amazon Mechanical Turk participants the CPS-style question "Last week did you have more than one job or business, including part time, evening or weekend work?" In total, 39% of respondents responded affirmatively. However, these participants were asked the follow-up question "Did you work on any gigs, HITs or other small paid jobs last week that you did not include in your response to the previous question?" After this question, which differs from the CPS, 61 percent of those who indicated that they did not hold multiple jobs on the CPS-style question acknowledged that they failed to report other work in the previous week. As Katz and Krueger write, "If these workers are added to the multiple job holders, the percent of workers who are multiple job holders would almost double from 39 percent to 77 percent." See L. Katz and A. Krueger, "Understanding Trends in Alternative Work Arrangements in the United States," RSF: The Russell Sage Foundation Journal of the Social Sciences 5(5), p. 132–46 (2019).

<sup>61</sup> K. Lim, A. Miller, M. Risch, and E. Wilking, "Independent Contractors in the U.S.: New Trends from 15 years of Administrative Tax Data," Department of Treasury, p. 61 (Jul. 2019), <https://www.irs.gov/pub/irs-soi/19rpindcontractorinus.pdf>.

<sup>62</sup> Washington Department of Commerce, "Independent Contractor Study," p. 21 (Jul. 2019), <https://deptofcommerce.app.box.com/v/independent-contractor-study>.

<sup>63</sup> In any given week, the total number of independent contractors would have been roughly

Farrell and Greig (2016) used a randomized sample of 1 million Chase customers to estimate prevalence of the Online Platform Economy.<sup>64</sup> They found that "[a]lthough 1 percent of adults earned income from the Online Platform Economy in a given month, more than 4 percent participated over the three-year period." Additionally, Collins et al. (2019) examined tax data from 2000 through 2016 and found that the number of workers who filed a form 1099 grew substantially over that period, and that fewer than half of these workers earned more than \$2,500 from 1099 work in 2016. The prevalence of lower annual earnings implies that most workers who received a 1099 did not work as an independent contractor every week.<sup>65</sup>

The CWS also uses proxy responses, which may underestimate the number of independent contractors. The RAND American Life Panel (ALP) survey conducted a supplement in 2015 to mimic the CWS questionnaire, but used self-responses only. The results of the survey were summarized by Katz and Krueger (2018).<sup>66</sup> This survey found that independent contractors comprise 7.2 percent of workers.<sup>67</sup> Katz and Krueger identified that the 0.5 percentage point difference in magnitude between the CWS and the ALP was due to both cyclical conditions, and the lack of proxy responses in the ALP.<sup>68</sup> Therefore, the Department believes a reasonable upper-bound on the potential bias due to the use of proxy responses in the CWS is 0.5 percentage points (7.2 versus 6.7).<sup>69 70</sup>

the same, but the identity of the individuals who do it for less than the full year would likely vary. Thus, the number of unique individuals who work at some point in a year as independent contractors would exceed the number of independent contractors who work within any one-week period as independent contractors.

<sup>64</sup> D. Farrell and F. Greig, "Paychecks, Paydays, and the Online Platform," JPMorgan Chase Institute (2016), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2911293](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2911293).

<sup>65</sup> Collins, Brett, Andrew Garin, Emile Jackson, Dmitri Koustas, and Mark Payne. 2019. "Is Gig Work Replacing Traditional Employment? Evidence from Two Decades of Tax Returns." Unpublished paper, IRS SOI Joint Statistical Research Program.

<sup>66</sup> See Katz and Krueger (2018), *supra* note 45.

<sup>67</sup> *Id.* at 49. The estimate is 9.6 percent without correcting for overrepresentation of self-employed workers or multiple job holders. *Id.* at 31.

<sup>68</sup> *Id.* at Addendum ("Reconciling the 2017 BLS Contingent Worker Survey").

<sup>69</sup> Note that they estimate 6.7 percent of employed workers are independent contractors using the CWS, opposed to 6.9 percent as estimated by the BLS. This difference is attributable to changes to the sample to create consistency.

<sup>70</sup> In addition to the use of proxy responses, this difference is also due to cyclical conditions. The impacts of these two are not disaggregated for independent contractors, but if we applied the relative sizes reported for all alternative work

<sup>57</sup> Bureau of Labor Statistics, "Contingent and Alternative Employment Arrangements—May 2017," USDL-18-0942 (June 7, 2018), <https://www.bls.gov/news.release/pdf/conemp.pdf>.

<sup>58</sup> The variables used are PES8IC = 1 for self-employed and PES7 = 1 for other workers.

<sup>59</sup> While self-employed independent contractors are identified by the worker's main job, other independent contractors answered yes to the CWS question about working as an independent contractor last week. Although the survey question does not ask explicitly about the respondent's main job, it follows questions asked in reference to the respondent's main job.

Another potential source of bias in the CWS is that some respondents may not self-identify as an independent contractor, and others who self-identify may be misclassified. There are reasons to believe that some workers, who are legally considered independent contractors, would not self-identify as such. For example, if the worker has only one employer/client, or did not actively pursue the employer/client, then they may not agree that they “[obtain] customers on their own to provide a product or service.” Additionally, individuals who do only informal work may not view themselves as independent contractors.<sup>71</sup> This population could be substantial. Abraham and Houseman (2019) confirmed this in their examination of the Survey of Household Economics and Decision-making. They found that 28 percent of respondents reported doing informal work for money over the past month.<sup>72</sup> Conversely, some workers misclassified as independent contractors may answer in the affirmative, despite not truly being independent contractors. The prevalence of misclassification is unknown, but it is generally agreed to be common.<sup>73</sup> Because reliable data on

arrangements, we would get 0.36 percentage point difference due to proxy responses. Additionally, it should be noted that this may not entirely be a bias. It stems from differences in independent contracting reported by proxy respondents and actual respondents. As Katz and Krueger explain, this difference may be due to a “mode” bias or proxy respondents may be less likely to be independent contractors. *Id.* at Addendum p. 4.

<sup>71</sup> The Department believes that including data on informal work is useful when discussing the magnitude of independent contracting, although not all informal work is done by independent contractors. The Survey of Household Economics and Decision-making asked respondents whether they engaged in informal work sometime in the prior month. It categorized informal work into three broad categories: Personal services, on-line activities, and off-line sales and other activities, which is broader than the scope of independent contractors. These categories include activities like house sitting, selling goods online through sites like eBay or Craigslist, or selling goods at a garage sale. The Department acknowledges that the data discussed in this study might not be a one-to-one match with independent contracting, but it nonetheless provides useful data for this purpose.

<sup>72</sup> Katherine G. Abraham, and Susan N. Houseman. 2019. “Making Ends Meet: The Role of Informal Work in Supplementing Americans’ Income.” RSF: The Russell Sage Foundation Journal of the Social Sciences 5(5): 110–31, <https://www.aeaweb.org/conference/2019/preliminary/paper/QreAaS2h>.

<sup>73</sup> See, e.g., U.S. Gov’t Accountability Off., GAO–09–717, *Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention* 10 (2008) (“Although the national extent of employee misclassification is unknown, earlier national studies and more recent, though not comprehensive, studies suggest that employee misclassification could be a significant problem with adverse consequences.”).

the potential magnitude of these biases are unavailable, and so the net direction of the biases is unknown, the Department has not calculated any estimates of how these biases may impact the estimated number of independent contractors.

Because the CWS estimate represents only the number of workers who worked as independent contractors on their primary job during the survey reference week, the Department applied the research literature and adjusted this measure to include workers who are independent contractors in a secondary job or who were excluded from the CWS estimate due to other factors. As noted above, integrating the estimated proportions of workers who are independent contractors on secondary or otherwise excluded jobs yields from other surveys produces estimates of 15.6 million and 22.1 million. The Department used the average of these two estimates, 18.9 million, as the estimated total number of workers working as independent contractors in any job at a given time. Given the prevalence of independent contractors who work sporadically and earn minimal income, adjusting the estimate according to these sources captures some of this population. It is likely that this figure is still an underestimate of the true independent contractor pool. The Department requests comments and data on the assumptions made to calculate this estimate.

## 2. Range of Estimates in the Literature

To further consider the range of estimates available, the Department conducted a literature review, the findings of which are presented in Table 3. Other studies were also considered but are excluded from this table because the study populations were broader than just independent contractors or limited

to one state.<sup>74</sup> The RAND ALP<sup>75</sup> and the General Social Survey’s (GSS’s) Quality of Worklife (QWL)<sup>76</sup> supplement are widely cited alternative estimates. However, the Department chose to use sources with significantly larger sample sizes and more recent data for the primary estimate.

Jackson et al. (2017)<sup>77</sup> and Lim et al. (2019)<sup>78</sup> use tax information to estimate the prevalence of independent contracting. In general, studies using tax data tend to show an increase in prevalence of independent contracting over time. The use of tax data has some advantages and disadvantages over survey data. Advantages include large sample sizes, the ability to link information reported on different records, the reduction in certain biases such as reporting bias, records of all activity throughout the calendar year (the CWS only references one week), and inclusion of both primary and secondary independent contractors. Disadvantages are that independent contractor status needs to be inferred; there is likely an underreporting bias (*i.e.*, some workers do not file taxes); researchers are generally trying to match the IRS definition of independent contractor, which does not mirror the scope of independent contractors under the FLSA; and the estimates include

<sup>74</sup> Including, but not limited to: McKinsey Global Institute, “Independent Work: Choice, Necessity, and the Gig Economy” (2016), <https://www.mckinsey.com/featured-insights/employment-and-growth/independent-work-choice-necessity-and-the-gig-economy>; Kelly Services, “Agents of Change” (2015); Robles and McGee, “Exploring Online and Offline Informal Work: Findings from the Enterprising and Informal Work Activities (EIWA) Survey” (2016); Upwork, “Freelancing in America” (2019); Washington Department of Commerce, *supra* note 62; Farrell and Greig, *supra* note 64; MBO Partners, “State of Independence in America” (2016); Abraham et al., “Measuring the Gig Economy: Current Knowledge and Open Issues” (2018), <https://www.nber.org/papers/w24950>; Collins et al., “Is Gig Work Replacing Traditional Employment? Evidence from Two Decades of Tax Returns,” IRS Working Paper (2019); Gitis et al., “The Gig Economy: Research and Policy Implications of Regional, Economic, and Demographic Trends,” American Action Forum (2017), <https://www.americanactionforum.org/research/gig-economy-research-policy-implications-regional-economic-demographic-trends/#ixzz5Ipbp79a>; Douardo and Koopman, “Evaluating the Growth of the 1099 Workforce,” Mercatus Center (2015), <https://www.mercatus.org/publication/evaluating-growth-1099-workforce>.

<sup>75</sup> See Katz and Krueger (2018), *supra* note 45.

<sup>76</sup> See Abraham et al., *supra* note 743, Table 4 (2018).

<sup>77</sup> E. Jackson, A. Looney, and S. Ramnath, “The Rise of Alternative Work Arrangements: Evidence and Implications for Tax Filing and Benefit Coverage,” OTA Working Paper 114 (2017), <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-114.pdf>.

<sup>78</sup> Lim et al., *supra* note 61.

misclassified independent contractors.<sup>79</sup> publicly available and thus the analyses characteristics of independent  
A major disadvantage of using tax data conducted cannot be directly verified or contractors, *etc.*).  
for this NPRM is that the data are not adjusted as necessary (e.g., to describe

TABLE 3—SUMMARY OF ESTIMATES OF INDEPENDENT CONTRACTING

Source	Method	Definition <sup>a</sup>	Percent of workers	Sample size	Year
CPS CWS .....	Survey .....	Independent contractor, consultant or free-lance worker (main only).	6.9	50,392 .....	2017
ALP .....	Survey .....	Independent contractor, consultant or free-lance worker (main only).	7.2	6,028 .....	2015
GSS QWL .....	Survey .....	Independent contractor, consultant or free-lancer (main only).	14.1	2,538 .....	2014
Jackson et al .....	Tax data .....	Independent contractor, household worker .....	<sup>b</sup> 6.1	<sup>c</sup> ~5.9 million .....	2014
Lim et al .....	Tax data .....	Independent contractor .....	8.1	1% of 1099—MISC and 5% of 1099—K.	2016

<sup>a</sup> The survey data only identify independent contractors on their main job. Jackson et al. include independent contractors as long as at least 15 percent of their earnings were from self-employment income; thus, this population is broader. If Jackson et al.'s estimate is adjusted to exclude those who are primary wage earners, the rate is 4.0 percent. Lim et al. include independent contractors on all jobs. If Lim et al.'s estimate is adjusted to only those who receive a majority of their labor income from independent contracting, the rate is 3.9 percent.

<sup>b</sup> Summation of (1) 2,132,800 filers with earnings from both wages and sole proprietorships and expenses less than \$5,000, (2) 4,125,200 primarily sole proprietorships and with less than \$5,000 in expenses, and (3) 3,416,300 primarily wage earners.

<sup>c</sup> Estimate based on a 10 percent sample of self-employed workers and a 1 percent sample of W-2 recipients.

### 3. Demographics of Independent Contractors

This section presents demographic information of independent contractors using the CWS, which, as stated above, only measures those who say that their independent contractor job is their primary job and that they worked at the independent contractor job in the survey's reference week. According to the CWS, these primary independent contractors are most prevalent in the construction and professional and business services industries. These two industries employ 44 percent of primary independent contractors. Independent contractors tend to be older and predominately male (65 percent). Millennials have a significantly lower prevalence of primary independent contracting than older generations: 3.6 percent for Millennials compared to 6.0 percent for Generation X and 8.8 percent for Baby Boomers and Matures.<sup>80</sup> However, surveys suggest that this trend is reversed when secondary independent contractors, or those who did informal work as independent contractors, are included.

These divergent data suggest that younger workers are more likely to use contractor work sporadically and/or for supplemental income.<sup>81</sup> White workers are somewhat overrepresented among primary independent contractors; they comprise 85 percent of this population but only 79 percent of the population of workers. Conversely, black workers are somewhat underrepresented (comprising 9 percent and 13 percent, respectively).<sup>82</sup> The opposite trends emerge when evaluating informal work, where racial minorities participate at a higher rate than white workers.<sup>83</sup> Primary independent contractors are spread across the educational spectrum, with no group especially overrepresented. The same trend in education attainment holds for workers who participate in informal work.<sup>84</sup>

#### D. Potential Transfers

The substantive effect of the rule is not intended to favor independent contractor or employee classification relative to the status quo. However, the Department assumes in this RIA that the increased legal certainty associated with

this proposed rule could lead to an increase in the number of independent contractor arrangements. The Department has not attempted to estimate the magnitude of this change, primarily because there are not objective tools for quantifying the clarity, simplification, and enhanced probative value of the Department's proposals for sharpening and focusing the economic reality test.<sup>85</sup> Therefore, potential transfers are discussed qualitatively with some numbers presented on a per worker basis. Potential transfers may result from differences in employer provided benefits, tax liabilities, and earnings between employees and independent contractors. Although employer-provided benefits could decrease, and tax liabilities could increase for these workers, the Department believes the net impact on total compensation should be small in either direction. Furthermore, in order to attract qualified workers, companies must offer competitive compensation. Therefore, in a competitive labor market, any reduction in benefits and increase in taxes is likely to be offset by

<sup>79</sup> In comparison to household survey data, tax data may reduce certain types of biases (such as recall bias) while increasing other types (such as underreporting bias). Because the Department is unable to quantify this tradeoff, it could not determine whether, on balance, survey or tax data are more reliable.

<sup>80</sup> The Department used the generational breakdown used in the MBO Partner's 2017 report, "The State of Independence in America." "Millennials" were defined as individuals born 1980–1996, "Generation X" were defined as individuals born 1965–1980, and "Baby Boomers and Matures" were defined as individuals born before 1965.

<sup>81</sup> Abraham and Houseman (2019), *supra* note 7272, find that informal work decreases as a

worker's age increases. Among 18 to 24 years olds, 41.3 percent did informal work over the past month. The rate fell to 25.7 percent for 45 to 54 year olds, and 13.4 percent for those 75 years and older. See also Upwork, "Freelancing in America" (2019).

<sup>82</sup> These numbers are based on the respondents who state that their race is "white only" or "black only" as opposed to identifying as being multi-racial.

<sup>83</sup> Abraham and Houseman (2019), *supra* note 72.

<sup>84</sup> *Id.*

<sup>85</sup> Another uncertainty limiting the Department's ability to quantify the possible increase in independent contracting is the nature and effect of state wage and hour laws. Some states, such as California, have laws that place more stringent

limitations on who may qualify as independent contractors than the FLSA. See Cal. Labor Code 2775 (establishing a demanding "ABC" test applicable to most workers when determining independent contractor status under California law). Because the FLSA does not preclude states and localities from establishing broader wage and hour protections than those that exist under the FLSA, see 29 U.S.C. 218(a), workers in some states may be unaffected by this proposed rule. However, because the Department is not well positioned to interpret the precise scope of each state's wage and hour laws, the Department is unable to definitively determine the degree to which workers in particular states would or would not be affected by this proposed rule.

higher base earnings—referred to as an “earnings premium.” As explained elsewhere, however, the data provides mixed evidence of this earnings premium.

Assuming that independent contractor arrangements increase following this proposed rule, it is unclear whether this would occur as a result of employees being subsequently classified as independent contractors or as a result of the hiring of new workers as independent contractors. This will have implications for transfers. If current employees change classifications, then there may be transfers. Employers could only change the classification of current employees if those workers had previously been misclassified or by changing the working conditions such that the relationship becomes a true independent contractor relationship, assuming doing so is consistent with any applicable employment contracts, collective bargaining agreement, or other applicable laws. Lim et al. (2019) found “little evidence that firms are increasingly reclassifying existing employee relationships as [independent contractor] relationships,” however, they found that “firms are hiring more new workers as [independent contractors] rather than as employees.”<sup>86</sup>

By decreasing uncertainty and thus potentially opening new opportunities for firms, companies may hire independent contractors who they otherwise would not have hired. In this case, there may be a decrease in unemployment and/or an increase in the size of the labor force. In a study of respondents from both Europe and the U.S., McKinsey Global Institute found that 15 percent of those not working are interested in becoming an independent contractor for their primary job.<sup>87</sup> Attracting these individuals to join the labor force would be considered a societal benefit, rather than a transfer, and therefore, is analyzed more fully below as part of the discussion on Cost Savings and Benefits.

The Department invites comment on its assumption that use of independent contractors will increase if the proposed rule is finalized. The Department also welcomes comments and data from companies looking to increase their use of independent contractors, specifically on whether employees’ classifications would change to independent contractor status, consistent with this proposed rule and their other contractual and legal obligations, or whether they would

instead hire new workers as independent contractors.

#### 1. Employer Provided Benefits

Although this rule only affects workers’ independent contractor status under the FLSA, the Department assumes in this analysis that employers are likely to keep the status of the worker the same across all benefits and requirements.<sup>88</sup> To the extent that employers currently provide employees benefits such as health insurance, retirement contributions, and paid time off, these would likely decrease with an increase in the use of independent contractors because independent contractors generally do not receive these benefits directly (although independent contractors are able to purchase at least some of these benefits for themselves). Employer provided benefits are a significant share of workers’ compensation. According to the BLS’s Employer Costs for Employee Compensation (ECEC), the value of employer benefits that directly benefit employees average 21 percent of total compensation.<sup>89</sup> The Department used the CWS to compare prevalence of health insurance and retirement benefits across employees and independent contractors. However, it should be noted that these two populations may differ in ways other than just their employment classification which may impact benefit amounts. For instance, an employee shifting to independent contractor status who already receives health benefits through a partner’s benefit plan would not be impacted by losing health benefit eligibility. Additionally, lower benefits may be offset by increased base pay in order to attract staff because workers consider the full package of pay and benefits when accepting a job.

According to the CWS’s relatively narrow definition of independent contractor:

- 79.4 percent of self-employed independent contractors have health

insurance. Most of these workers either purchased insurance on their own (31.5 percent) or have access through their spouse (28.6 percent).

- 80.7 percent of other independent contractors have health insurance. There are three main ways these workers receive health insurance: Through their spouse (25.1 percent), through an employer (24.2), or on their own (20.1 percent).

- 88.3 percent of employees have health insurance. Most of these workers receive health insurance through their work (64.1 percent). Furthermore, according to the ECEC, employers pay on average 12 percent of an employee’s base compensation in health insurance premiums.

From these data, it is unclear exactly how health insurance coverage would change if the number of independent contractors increased, but the data suggest that independent contractors, on average, may be less likely to have health insurance coverage. That said, employment is not a guarantee of health insurance, nor do independent contractors generally lack health insurance.

A major source of retirement savings is employer sponsored retirement accounts. According to the CWS, 55.5 percent of employees have a retirement account with their current employer; in addition, the ECEC found that employers pay 5.3 percent of employees’ total compensation in retirement benefits on average (\$1.96/\$37.03). If a worker shifts from employee to independent contractor status, that worker may no longer receive employer-provided retirement benefits, but may choose alternate investment options. As with health insurance, it is not clear whether retirement savings for such a worker would increase or decrease, but such a worker would need to take a more active role in saving for retirement vis-à-vis an employee with an employer-sponsored retirement plan.

#### 2. Tax Liability

Payroll tax liability is generally divided between the employer and the employee in the United States. Most economists believe that the “incidence” of the payroll tax, regardless of liability, falls on the employee.<sup>90</sup> As self-

<sup>88</sup> Courts have noted that the FLSA has the broadest conception of employment under federal law. *See, e.g., Darden*, 503 U.S. at 326. To the extent that businesses making employment status determinations base their decisions on the most demanding federal standard, a rulemaking addressing the FLSA’s distinction between employees and independent contractors may affect the businesses’ classification decisions for purposes of benefits and legal requirements under other federal and state laws.

<sup>89</sup> BLS, “Employer Costs for Employee Compensation News Release” (Sept. 2019), [https://www.bls.gov/news.release/archives/ecec\\_12182019.htm](https://www.bls.gov/news.release/archives/ecec_12182019.htm), Civilian Workers. This includes paid leave (\$2.68), insurance (\$3.22), and retirement and savings benefits (\$1.96). It does not include overtime and premium pay, shift differential pay, nonproduction bonuses, or legally required benefits. Calculated as (\$2.68 + \$3.22 + \$1.96)/\$37.03.

<sup>86</sup> Lim et al., *supra* note 61 at 3.

<sup>87</sup> McKinsey Global Institute, *supra* note 74 at 71.

<sup>90</sup> The share of payroll taxes borne by employees versus firms is unknown but economists generally believe that employer payroll taxes are partially-to-completely shifted to employees in the long run. For a detailed review of the literature see J. Deslauriers, B. Dostie, R. Gagné, and J. Paré, “Estimating the Impacts of Payroll Taxes: Evidence from Canadian Employer-Employee Tax Data,” IZA

employed workers, independent contractors are legally obligated to pay both the employee and employer shares of the Federal Insurance Contributions Act (FICA) taxes. Thus, if workers' classifications change from employees to independent contractors, there may be a transfer in federal tax liabilities from employers to workers (regardless of whether this affects the actual cost of these taxes to the worker). These payroll taxes include:<sup>91</sup>

- Social Security tax: The 6.2 percent employer component (half of the 12.4 percent total).<sup>92</sup>
- Medicare tax: The 1.45 percent employer component (half of the 2.9 percent total).<sup>93</sup>

In sum, independent contractors are legally responsible for an additional 7.65 percent of their earnings in FICA taxes vis-à-vis an employee. However, any tax-related transfers from employers to workers are likely to be offset by higher wages employers pay to ensure workers' take-home pay remains the same.

Companies also cover unemployment insurance and workers' compensation taxes for their employees. Independent contractors may choose to pay for comparable insurance protection offered in the private market, but are not obligated to. The resulting regulatory effect (experienced as savings, either by companies or employees, depending on who ultimately bears the cost of the tax) combines societal cost savings (the lessened administrative cost of incrementally lower participation in unemployment insurance and workers' compensation programs) and transfers (from individuals whose unemployment insurance or workers' compensation payments decline, to entities paying less in taxes). Independent contractors may recoup some or all of the employer portion of these taxes and insurance premiums in the form of increased wages. This rule could decrease employers' tax liabilities and increase independent contractors' take-home compensation. However, there are costs to independent contractors if they become unemployed or injured or ill on the job because they no longer are

protected, unless they purchase their own private insurance. The Department did not attempt to quantify the cost of changes in coverage or whether the net effect is a benefit or cost to the worker.

### 3. Earnings

Although the minimum wage and overtime pay requirements of the FLSA would no longer apply to workers who shift from employee status to independent contractor status, the Department anticipates an increase in labor force activity. That said, the Department does not attempt to quantify the magnitude of any increase in earnings as a result of increased labor force activity.

If currently unemployed workers or individuals who are out of the labor market become independent contractors due to this rule, their earnings will increase as they currently have no employment-related earnings other than possibly unemployment benefits. The impact on earnings is more ambiguous if employees' classifications change to independent contractors. In theory, companies would likely have to pay more per hour to independent contractors than to employees because independent contractors generally do not receive employer-provided benefits and have higher tax liabilities. Data show an hourly wage premium for independent contractors when comparing unconditional means. But as the analysis below shows, when controlling for certain differences in worker characteristics, this expected wage premium may not always be observable at a statistically significant level. It should be noted, however, that these estimates do not attempt to incorporate the value of flexibility and satisfaction that independent contractors cite as key factors in their preference of independent contracting arrangements over traditional employment.

Comparing the average earnings, hourly wages, and hours of current employees and independent contractors may provide some indication of the impact on wages of a worker who transitions from an employee to independent contractor classification. A regression analysis that controls for observable differences between independent contractors and employees may help isolate the impact on earning, hourly wages, and usual hours of being an independent contractor. Katz and Krueger (2018)<sup>94</sup> regressed the natural log of usual weekly earnings, the natural log of hourly wages, and the natural log of weekly hours worked on independent

contractor status,<sup>95</sup> occupation, sex, potential experience, potential experience squared, education, race, and ethnicity. They use the 2005 CWS and the 2015 RAND ALP (the 2017 CWS was not available at the time of their analysis). The Department conducted similar regressions using the 2017 CWS. In both Katz and Krueger's regression results and the Department's calculations of unconditional averages in the 2017 CWS data presented below, the following outlying values were removed: Workers reporting earning less than \$50 per week, less than \$1 per hour, or more than \$1,000 per hour.<sup>96</sup>

The Department combined the CWS data on usual earnings per week and hours worked per week to estimate hourly wage rates.<sup>97</sup> Examining mean earnings, the Department found that independent contractors tend to earn more per hour: Employees earned an average of \$24.07 per hour, self-employed independent contractors earned an average of \$27.43 per hour, and other independent contractors earned an average of \$26.71 per hour (the average hourly wage is \$27.29 when combining the two types of independent contractors).<sup>98</sup> Katz and Krueger conducted similar hourly earnings estimates based on 2005 CWS and 2015 ALP data. Their analysis of the 2005 CWS data indicated that "[b]efore conditioning on covariates, the 2005 and 2015 results are similar: Freelancers

<sup>95</sup> On-call workers, temporary help agency workers, and workers provided by contract firms are excluded from the base group of "traditional" employees.

<sup>96</sup> Choice of exclusionary criteria from Katz and Krueger (2018), *supra* note 45.

<sup>97</sup> The CWS data, based on its relatively narrow definition of independent contractors, indicated that employees worked more hours per week in comparison to primary independent contractors. The Department found that 81 percent of employees worked full-time, compared to 72 percent for self-employed independent contractors and 69 percent for other independent contractors. Katz and Krueger similarly found that independent contractors work fewer hours per week than employees (statistically significant at the 1 percent level of significance in all specifications with both datasets). Despite working fewer hours per week than employees, self-employed independent contractors earned more per week on average (\$980 per week compared to \$943 per week). Other independent contractors, on average, worked fewer hours per week and earned less per week than employees (\$869 per week compared to \$943 per week). Given the difference between hours worked by primary independent contractors and employees, and the appeal of flexibility cited by many independent contractors, average weekly earnings may be an inadequate measure. Accordingly, the Department's analysis focuses on hourly wages.

<sup>98</sup> The Department followed Katz and Krueger's methodology in excluding observations with weekly earnings less than \$50, hourly wages less than \$1, or with hourly wages above \$1,000. Additionally, workers with weekly earnings above \$2,885 are topcoded at \$2,885. Weekly earnings are used to calculate imputed hourly wages.

Institute of Labor Economics Discussion Paper Series IZA DP No. 11598 (June 2018), <http://ftp.iza.org/dp11598.pdf>. Further information is available by the Tax Foundation, <https://taxfoundation.org/what-are-payroll-taxes-and-who-pays-them/>.

<sup>91</sup> Internal Revenue Service, "Publication 15, (Circular E), Employer's Tax Guide" (Dec. 23, 2019), <https://www.irs.gov/pub/irs-pdf/p15.pdf>.

<sup>92</sup> The social security tax has a wage base limit of \$137,700 in 2020.

<sup>93</sup> An additional Medicare Tax of 0.9 percent applies to wages paid in excess of \$200,000 in a calendar year for individual filers.

<sup>94</sup> See Katz and Krueger (2018), *supra* note 45.



and contract workers are paid more per hour than traditional employees.”<sup>99</sup> When controlling for education, potential experience, race, ethnicity, sex and occupation, independent contractors’ higher hourly wages in the 2005 CWS data were not statistically significant. But Katz and Krueger’s analysis of the 2015 ALP data under the same specifications found that primary independent contractors earned more per hour than traditional employees with a statistically significant degree of confidence.<sup>100</sup>

Conceptually, the Department expects that independent contractors would earn more per hour than traditional employees in base compensation as an offset to employer-provided benefits and increases in tax liabilities. Katz and Krueger’s analysis of the 2015 RAND ALP data appears to support this prediction.<sup>101</sup> However, they recommend caution in interpreting the estimates from the ALP due to the relatively small sample size. Their analysis of the 2005 CWS data and the Department’s similar analysis of 2017 CWS data did not show a statistically significant difference. But as previously noted, comparing current employees to current primary independent contractors may not be indicative of how earnings would change for current employees who became independent contractors. Nor do such wage-based comparisons reflect the non-pecuniary attributes of employees and independent contractors.<sup>102</sup>

One potential reason for the variance among the estimates for independent contractor wages could be error in the measurement of independent contractor status and earnings, a factor that is present throughout all of the analyses in this area. As a recent analysis concluded, “different data sources provide quite different answers to the simple question of what is the level and

trend of self-employment in the U.S. economy,” which suggest substantial measurement error in at least some data sources.<sup>103</sup> As noted above, reporting errors by survey respondents may contribute to measurement error in CWS data.<sup>104</sup> Additionally, CWS questions “were asked only about people who had already been identified as employed in response to the survey’s standard employment questions and only about their main jobs,” and therefore may miss important segments of the population. BLS has recently acknowledged limitations in the 2017 CWS survey in response to a GAO audit and is reevaluating how it would measure independent contractors in the future.<sup>105</sup>

Another potential bias in the Department’s results could be due to the exclusion of relevant explanatory variables from the model specification, including the omission of observable variables that correlate with hourly earnings. For example, the Department’s analysis of 2017 CWS data used 22 occupation dummy variables but did not control for a worker’s job position within any of the occupations (although it did control for “potential experience”). However, as the Department’s Guidance indicates, a statistical comparison of earnings between workers generally must control for “job level or grade” in addition to experience to ensure the comparison is for workers in similar jobs.<sup>106</sup> If, hypothetically, independent contractors on average have lower job levels (or equivalents) than traditional employees

within each occupation,<sup>107</sup> the Department’s analysis would not be comparing the hourly earnings of primary independent contractors and employees who have the same jobs. Instead, the Department would be comparing a population of relatively low-level independent contractors with a population that includes both low- and high-level employees.

The existence of unobservable differences between independent contractors and employees that are correlated with earnings, such as productivity, skill, and preference for flexibility also bias comparison of hourly earnings. For example, independent contractors may be on average more willing than employees to trade monetary compensation for increased workplace flexibility, which would obscure the observability of an earnings premium for independent contractors. It is possible that independent contractors’ hourly earnings premium may be best observed at the margin, such as comparing a worker’s behavior when deciding between two similar positions, one as an employee and one as an independent contractor.

Labor market frictions and personal preferences facing both employers and workers may further prevent a clear detection of a full picture of any earnings premium. Employees that transition to independent contractor classification may prefer monetary compensation over employer-provided benefits (e.g., subsidies for health insurance when they already have other coverage).<sup>108</sup> The non-pecuniary benefits of independent contracting, such as workplace flexibility, may impact the observability of an earnings premium. Specifically, a range of research shows that workers are willing to accept lower wages in exchange for increased flexibility.<sup>109</sup>

An additional consideration is that minimum wage and overtime pay would no longer apply if workers shift from employee status to independent contractor status. The 2017 CWS data

<sup>99</sup> *Id.* at 19.

<sup>100</sup> *Id.* at 34.

<sup>101</sup> See Katz and Krueger (2018), *supra* note 45 at 20 (“A positive hourly wage premium for independent contractors could reflect a compensating differential for lower benefits and the need to pay self-employment taxes.”).

<sup>102</sup> In particular, at least some research reveals significant non-pecuniary advantages to independent contracting, including through increased job satisfaction. See “The State of Independence in America,” MBO Partners (2019), <https://www.mbopartners.com/state-of-independence/>; Chen et al., “The Value of Flexible Work: Evidence from Uber Drivers,” *Journal of Political Economy* 127:6, 2735–794 (2019); He, H. et al., “Do Workers Value Flexible Jobs? A Field Experiment,” NBER Working Paper No. w25423, (2019), <https://ssrn.com/abstract=3311395>; McKinsey Global Institute, *supra* note 74; Upwork, “Freelancing in America” (2019).

<sup>103</sup> Abraham et al., *supra* note 74, at 15.

Generally, “[h]ousehold surveys consistently show lower levels of self-employment than tax data and a relatively flat or declining long-term trend in self-employment as contrasted with the upward trend that is evident in tax data.” *Id.*; see also *id.* at 45.

<sup>104</sup> “For example, a household survey respondent might fail to mention informal work that they do not think of as a job, something that further probing might uncover. To take another example, a household member who is doing work for a business may be reported as an employee of that business, even in cases where further probing might reveal that the person is in fact an independent contractor or freelancer.” *Id.* at 15.

<sup>105</sup> Specifically, BLS recognized that: (1) The “CWS measures only respondents’ main jobs . . . , thus potentially missing workers with nontraditional second or supplementary income jobs”; (2) “CWS only asks respondents about their work in the past week and may fail to capture seasonal workers or workers that supplement their income with occasional work”; and (3) “added questions regarding electronically-mediated employment resulted in a large number of false positive answers.” Government Accountability Office, Contingent Workforce: BLS is Reassessing Measurement of Nontraditional Workers, Jan. 29, 2019, <https://www.gao.gov/assets/700/696643.pdf>.

<sup>106</sup> Department of Labor, Office of Federal Contracting Compliance Programs, Directive 2018–5, Aug. 24, 2018, <https://www.dol.gov/agencies/ofccp/directives/2018-05#ftn.id10>.

<sup>107</sup> For example, because individuals working as independent contractors are less likely to be in positions with managerial responsibilities over other workers.

<sup>108</sup> Research using hedonic wage models has found mixed results on the trade-off between pay and benefits, with some researchers finding a positive correlation between increased pay and benefits, rather than a trade-off. See Simon, K. (2001), Displaced workers and employer-provided health insurance: Evidence of a wage/fringe benefit tradeoff? *Int J Health Care Finance Econ.* (3–4): 249–71. <https://www.ncbi.nlm.nih.gov/pubmed/14625928>.

<sup>109</sup> He, H. et al. 2019. Do Workers Value Flexible Jobs? A Field Experiment. NBER Working Paper No. w25423. <https://ssrn.com/abstract=3311395>.

indicate that, before conditioning on covariates, independent contractors under the narrower definition of primary, active work are more likely than employees to report earning less than the FLSA minimum wage of \$7.25 per hour (8 percent for self-employed independent contractors, 5 percent for other independent contractors, and 2 percent for employees). That data further indicated that, before conditioning on covariates, primary independent contractors are more likely to work overtime at their main job (30 percent for self-employed independent contractors and 19 percent for other independent contractors versus 18 percent for employees). The Department was unable to determine whether these differences were the result of differences in worker classification, as opposed to other factors.

#### E. Costs

The Department estimated that regulatory familiarization costs will total \$370.9 million in Year 1.

##### 1. Regulatory Familiarization Costs

Regulatory familiarization costs represent direct costs to businesses and current independent contractors associated with reviewing the new regulation. To estimate the total regulatory familiarization costs, the Department used (1) the number of establishments, government entities, and current independent contractors; (2) the wage rates for the employees and for the independent contractors reviewing the rule; and (3) the number of hours that it estimates employers and independent contractors will spend reviewing the rule. This section presents the calculation for establishments first and then the calculation for independent contractors.

It is not clear whether regulatory familiarization costs are a function of the number of establishments or the number of firms.<sup>110</sup> Presumably, the headquarters of a firm will conduct the regulatory review for businesses with multiple locations, and may also require some locations to familiarize themselves with the regulation at the establishment level. Other firms may either review the rule to consolidate key takeaways for

their affiliates or they may rely entirely on outside experts to evaluate the rule and provide the relevant information to their organization (e.g., a chamber of commerce). The Department used the number of establishments to estimate the fundamental pool of regulated entities—which is larger than the number of firms. This assumes that regulatory familiarization occurs at both the headquarters and establishment levels.

There may be differences in familiarization cost by the size of establishments; however, the analysis does not compute different costs for establishments of different sizes. Furthermore, the analysis does not revise down for states where the laws may more stringently limit who qualifies as an independent contractor (such as California). To estimate the number of establishments incurring regulatory familiarization costs, the Department began by using the Statistics of U.S. Businesses (SUSB) to define the total pool of establishments in the United States.<sup>111</sup> In 2017, the most recent year available, there were 7.86 million establishments. These data were supplemented with the 2017 Census of Government that reports 90,075 local government entities, and 51 state and federal government entities.<sup>112</sup> The total number of establishments and governments in the universe used for this analysis is 7,950,800.

The applicable universe used by the Department for assessing familiarization costs of this proposed rule is all establishments that engage independent contractors, which is a subset of the universe of all establishments. The Department estimates the impact of regulatory familiarization based upon assessment of the regulated universe. For the Department's recent Joint Employer Status under the Fair Labor Standards Act, Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, and Regular Rate Under the Fair Labor Standards Act rulemakings, it estimated that the regulated universe comprised all establishments because the rules were broadly applicable to every employer. For those rules, the Department estimated familiarization costs by assuming each establishment would review each rule. Because the proposed rule affects only some

establishments, *i.e.*, those that do or may face an independent contractor versus employee classification determination, the Department accordingly reduces the estimated pool to better estimate the establishments affected by the rule by assessing regulatory familiarity costs only for those establishments that engage independent contractors.

In 2019, Lim et al. used extensive IRS data to model the independent contractor market, finding that 34.7 percent of firms have any independent contractors.<sup>113</sup> These data are based on annual tax filings, so the dataset includes firms that may contract for only parts of a year. This figure forms the foundation of the multiplier used in this analysis. The Department requests public comments and data on these assumptions.

OMB Circular A–4 instructs that regulatory impact analyses establish a baseline, usually a “no action” baseline, to represent what the world is expected to be like in the absence of the proposed rule.<sup>114</sup> In the absence of this proposed rule, establishments that do not currently have any independent contractors but are looking to hire one or more will need to familiarize themselves with the current legal framework.<sup>115</sup> Accordingly, firms that do not currently use independent contractors are not counted in this universe of employers; however, to allow for an error margin, the Department is using a rounded 35 percent of the total number of establishments defined above (7,950,800), resulting in 2,782,780 establishments estimated to incur familiarization costs.

The Department assumes that a Compensation, Benefits, and Job Analysis Specialist (SOC 13–1141) (or a staff member in a similar position) will review the rule.<sup>116</sup> According to the

<sup>113</sup> Table 10: Firm sample summary statistics by year (2001–2015), <https://www.irs.gov/pub/irs-soi/19rpindcontractorinus.pdf>.

<sup>114</sup> OMB Circular A–4, [https://www.reginfo.gov/public/jsp/Utilities/circular-a-4\\_regulatory-impact-analysis-a-primer.pdf](https://www.reginfo.gov/public/jsp/Utilities/circular-a-4_regulatory-impact-analysis-a-primer.pdf).

<sup>115</sup> An added dimension is that the proposed rule is expected to provide significant clarity, which would result in time and cost savings (net of regulatory familiarization costs) for those outside the pool of firms with existing independent contractor relationships. These (net) cost savings are not included in this analysis, consistent with this analysis' treatment of resulting growth in the independent contractor universe.

<sup>116</sup> A Compensation/Benefits Specialist ensures company compliance with federal and state laws, including reporting requirements; evaluates job positions, determining classification, exempt or non-exempt status, and salary; plans, develops, evaluates, improves, and communicates methods and techniques for selecting, promoting, compensating, evaluating, and training workers. See

<sup>110</sup> An establishment is commonly understood as a single economic unit, such as a farm, a mine, a factory, or a store, that produces goods or services. Establishments are typically at one physical location and engaged in one, or predominantly one, type of economic activity for which a single industrial classification may be applied. An establishment contrasts with a firm, or a company, which is a business and may consist of one or more establishments. See BLS, “Quarterly Census of Employment and Wages: Concepts,” <https://www.bls.gov/opub/hom/cew/concepts.htm>.

<sup>111</sup> U.S. Census Bureau, 2017 SUSB Annual Data Tables by Establishment Industry. <https://www.census.gov/data/tables/2017/econ/susb/2017-susb-annual.html>.

<sup>112</sup> U.S. Census Bureau, 2017 Census of Governments. <https://www.census.gov/data/tables/2017/econ/gus/2017-governments.html>.

Occupational Employment Statistics (OES), these workers had a mean wage of \$33.58 per hour in 2019 (most recent data available). Given the proposed clarification to the Department's interpretation of who is an employee and who is an independent contractor under the FLSA, the Department assumes that it will take on average about 1 hour to review the rule as proposed. The Department believes that an hour, on average, is appropriate, because while some establishments will spend longer than one hour to review the rule, many establishments may rely on third-party summaries of the changes or spend little or no time reviewing the rule. Assuming benefits are paid at a rate of 46 percent of the base wage, and overhead costs are 17 percent of the base wage, the reviewer's effective hourly rate is \$54.74; thus, the average cost per establishment conducting regulatory familiarization is \$54.74. Therefore, regulatory familiarization costs to businesses in Year 1 are estimated to be \$152.3 million (\$54.74 × 2,782,780) in 2019 dollars.

For regulatory familiarization costs for independent contractors, the Department used its estimate of 18.9 million independent contractors and assumed each independent contractor will spend 15 minutes to review the regulation. The time estimates used for independent contractors is estimated to be smaller than for establishments. This difference is in part because the Department believes independent contractors are likely to rely on summaries of the key elements of the rule change published by the Department, worker advocacy groups, media outlets, and accountancy and consultancy firms, as has occurred with other rulemakings. Furthermore, the repercussions for independent contractors are smaller (*i.e.*, the costs associated with misclassification tend to fall on establishments). This time is valued at \$46.36, which is the mean hourly wage rate for independent contractors in the CWS, \$27.27, with an additional 46 percent benefits and 17 percent for overhead, then updated to 2019 dollars.

The estimate of 18.9 million independent contractors captures the universe of workers over a one-year period. Using this figure for the overall cost estimate results in an artificially high value because it includes workers who would have otherwise been included in the baseline case without the proposed rule and thus spent time

familiarizing themselves with the legal framework in the matter of course, without incurring a supplementary cost. Furthermore, the Department believes that it is probable that independent contractors would review the regulation only when they had reason to believe that the benefits would outweigh the costs incurred in familiarizing themselves with the rule, and since this analysis does not attempt to calculate those economic benefits it is possible that the costs presented in this section are overestimated.<sup>117</sup>

The total one-time regulatory familiarization costs for independent contractors are estimated to be \$218.6 million. The total one-time regulatory familiarization costs for establishments and independent contractors are estimated to be \$370.9 million.

Regulatory familiarization costs in future years are assumed to be de minimis. Similar to the baseline case for employers, independent contractors would continue to familiarize themselves with the applicable legal framework in the absence of the rule, so this proposed rulemaking—anticipated to provide more clarity—is not expected to impose costs after the first year.<sup>118</sup> This amounts to a 10-year annualized cost of \$43.5 million at a discount rate of 3 percent or \$52.8 million at a discount rate of 7 percent.

## 2. Other Costs

There may be other costs associated with this NPRM that have not been quantified due to uncertainties or data limitations. The Department invites public comments and data to address this issue.

## F. Cost Savings

This NPRM is expected to result in cost savings to firms and workers. The Department has quantified only the cost savings from increased clarity and reduced litigation. The other areas of anticipated cost savings were not estimated due to uncertainties or data limitations. The Department welcomes data and comments on the potential cost savings and benefits to society.

## 1. Increased Clarity

This proposed rule is expected to increase clarity concerning whether a worker is classified as an employee or

as an independent contractor under the FLSA. This would reduce the burden faced by employers, potential employers, and workers to understand the distinction and how the working relationship should be classified. It is unclear exactly how much time would be saved, but the Department provides some quantitative estimates to provide a sense of the magnitude. To quantify this benefit, the following variables need to be defined and estimated: (1) The number of new employer-worker relationships being assessed to determine the appropriate classification; (2) the amount of time saved per assessment; and (3) an average wage rate for the time spent. The Department estimates this will result in a \$447.2 million in savings annually. The Department requests comments on these assumptions and calculations.

The Department began with its estimate of the number of current independent contractors as the basis for estimating the number of new relationships. As discussed in section VI.C, according to the CWS, there are 10.6 million workers who are independent contractors on their primary job. Adjusting this figure to account for independent contractors on their secondary job results in 18.9 million independent contractors. According to Lim et al. (2019), in 2016 the average number of 1099–MISC forms issued per independent contractor was 1.43. Therefore, the Department assumes the average independent contractor has 1.43 jobs per year.<sup>119</sup> This number does not account for the workers who do not file taxes, a recognized limitation in the cited study. Because it is unclear whether those who do not file taxes would have a higher or lower number jobs per year, the Department does not believe that this biases the estimate in either direction. Multiplying these two numbers results in an estimated 27.0 million new independent contractor relationships each year.<sup>120</sup>

The independent contracting sector is characterized by churn. In their annual *State of Independence in America* 2019 report, MBO Partners, a leading American staffing firm, finds that 47.8

<sup>119</sup> Lim et al., *supra* note 61, at 61.

<sup>120</sup> The Department in this analysis did not incorporate estimates of potential growth in independent contracting due to uncertainty. For example, the trend in independent contracting varies significantly based on the source. Additionally, the impact of this rule on the prevalence of independent contracting is uncertain. Lastly, state laws, such as those in California discussed below, may have significant impacts on the prevalence of independent contracting, which would make historical growth rates potentially inappropriate.

BLS, “13–1141 Compensation, Benefits, and Job Analysis Specialists,” <https://www.bls.gov/oes/current/oes131141.htm>.

<sup>118</sup> As explained below, the Department considers that the regulation may produce benefits along this dimension in future years by simplifying the regulatory environment.

percent of U.S. adults reported working as an independent contractor at some point in their career; they estimate that figure will reach 53 percent in the next five years.<sup>121</sup> This fits with the range of estimates for the size of the independent contractor universe presented in section VI.C. Thus, it is assumed that over the ten-year time horizon of this analysis, millions of Americans will choose independent contractor work either for the first time or return to it. This churn is not explicitly estimated for use in this analysis, but it provides a qualitative rationale for not attempting to taper the expected size of the independent contractor universe over time. The Department requests comments and data on these assumptions.

A subset of new independent contractor relationships may have time savings associated with the proposed rule. Such a reduction is difficult to quantify because it is unclear how many establishments and independent contractors will realize benefits of increased clarity. It is also possible that the increased clarity of the classification process will lead to compound effects that generate far greater benefits over time. Nonetheless, because it is possible that only a subset of contracts would receive the cost savings associated with increased clarity, the Department has reduced the number of contracts in the estimate by 25 percent. This results in 20.2 million contracts with cost savings to both the employer and the independent contractor.<sup>122</sup> The Department requests comments and data on this assumption.

Per each new contract with time savings, the Department has assumed that employers would save 20 minutes of time and independent contractors would save 5 minutes.<sup>123 124</sup> These numbers are small because they represent the marginal time savings for each contract, not the entire time necessary to identify whether an independent contractor relationship holds. For employers, this time is valued at a loaded hourly wage rate of \$54.74. This is the mean hourly rate of

Compensation, Benefits & Job Analysis Specialists (13–1141) from the OES multiplied by 1.63 to account for benefits and overhead. For independent contractors, this time is valued at \$46.36 per hour (mean wage rate for independent contractors in the CWS of \$27.29 with the amount of benefits and overhead paid by employers for employees, then adjusted to 2019 dollars using the GDP deflator).

Using these numbers, the Department estimates that employers will save \$369.0 million annually and independent contractors will save \$78.1 million annually due to increased clarity (Table 4). In sum, this is estimated to be a \$447.2 million savings. The Department assumes the parameters used in this cost savings estimate will remain constant over time. This assumes no growth in independent contracting, no real wage growth, and no subsequent innovation in the employer-worker relationship. These assumptions, while highly unlikely to be true in reality, facilitate simplicity of calculation. The annualized savings over both a 10-year horizon and in perpetuity, with both the 3 percent and 7 percent discount rates is \$447.2 million.

In addition to increased clarity when assessing whether each relationship qualifies as an independent contractor or employment relationship, there may also be upfront time savings for new entrants who must familiarize themselves with the definition of an employee as compared to an independent contractor, and who now have clearer guidance to aid in that understanding. This would apply to new independent contractors, new establishments, and current establishments that are considering hiring independent contractors for the first time. The Department did not quantify this benefit due to uncertainty and the difficulty of determining reliable variables. However, such benefits are expected to be real and significant. The Department requests comments and data to address these constraints.

TABLE 4—COST SAVINGS FOR INCREASED CLARITY TO EMPLOYERS AND INDEPENDENT CONTRACTORS

Parameter	Value
Number of new relationships (per year):	
Independent contractors ...	18,858,000
Number of jobs per contractor .....	1.43
New independent contractor jobs .....	26,966,940

TABLE 4—COST SAVINGS FOR INCREASED CLARITY TO EMPLOYERS AND INDEPENDENT CONTRACTORS—Continued

Parameter	Value
Adjustment factor .....	75%
Total .....	20,225,205
Time savings per job (minutes):	
Employers .....	20
Independent contractors ...	5
Value of time:	
Employers .....	\$54.74
Independent contractors ...	\$46.36
Total savings:	
Employers .....	\$369,042,574
Independent contractors ...	\$78,137,248
Total .....	\$447,179,822

## 2. Reduced Litigation

These proposed changes are expected to result in decreased litigation due to increased clarity and reduced misclassification. The Department provides analysis here to assess the potential magnitude of this cost savings. The methodology of this section mirrors previous final rules promulgated in recent years. The Department requests comments on the assumptions in this section.<sup>125</sup>

The Department estimates that, due to increased clarity on independent contractor status, \$33.6 million in litigation costs will be avoided per year. To reach this estimate, the Department determined that there were 6,711 federal cases relating to the FLSA filed in 2019.<sup>126</sup> Of these cases, the Department estimates that 7 percent of these cases relate to independent contractor status. To determine this percentage, the Department reviewed a random sample of 500 of the FLSA cases closed in 2014 (8,256 cases).<sup>127</sup> Of those cases, the Department identified 35 cases within this sample that related to independent contractor status. This ratio was applied to the 6,711 FLSA cases from 2019 to

<sup>125</sup> The Department applied a similar approach to litigation costs in the 2019 final rule *Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees*, 81 FR 51230 (2019).

<sup>126</sup> Downloaded from Public Access to Court Electronic Records (PACER).

<sup>127</sup> The Department used data from 2014 already obtained for use in the analysis performed for the 2019 overtime and regular rate final rules. See 84 FR 51230, 51280–81 (reduced litigation estimate for the final rule updating the FLSA's white collar exemptions at 29 CFR part 541); 84 FR 68736, 68767–68 (reduced litigation estimate for the final rule updating the FLSA's "regular rate" regulations at 29 CFR part 778). The Department invites comment on its methodology but has no reason to believe that a more recent sample would materially affect the results in this analysis.

<sup>121</sup> State of Independence in America, MBO Partners (2019). <https://www.mbopartners.com/state-of-independence/>.

<sup>122</sup> 18.9 million ICs × 1.43 contracts per year × (1 – 0.25 possible reduction in clarity benefits) = 20.2 million.

<sup>123</sup> These time savings are based on a 33 percent assumed reduction in the estimated familiarization time per contract for both independent contractors (15 minutes) and employers (1 hour).

<sup>124</sup> The Department requests comment on whether more meaningful estimates would distinguish between time periods (with, for example, relatively large upfront savings at the time contracts are arranged and smaller ongoing amounts) and/or would vary by affected industry.

estimate 470 cases related to independent contractor status. The Department assumes that the increased clarity of the proposed rule would reduce litigation in this area by 10 percent as stakeholders would better understand and be better able to agree on classification determinations. This estimate is based on an initial Departmental review of FLSA cases, and the Department requests comments and data to help inform and refine this assumption. Multiplying these variables results in an estimated 47 cases avoided annually.

Next, the Department applied a previous estimate of litigation costs of \$654,182 per case. To obtain this estimate, the Department examined a selection of 56 FLSA cases concluded between 2012 and 2015 that contained litigation cost information to estimate the average costs of litigation.<sup>128</sup> The Department looked at records of court filings in the Westlaw Case Evaluator tool and on PACER to ascertain how much plaintiffs in these cases were paid for attorney fees, administrative fees, and/or other costs, apart from any monetary damages attributable to the alleged FLSA violations. After determining the plaintiff's total litigation costs for each case, the Department then doubled the figures to account for litigation costs that the defendant employers incurred. According to this analysis, the average litigation cost for FLSA cases concluded between 2012 and 2015 was \$654,182. Adjusting for inflation, using the GDP deflator, results in a value of \$715,637 in 2019.<sup>129</sup>

Applying these figures to the estimated 47 cases that could be prevented each year due to this rulemaking, the Department estimates that avoided litigation costs resulting

from the rule total \$33.6 million per year (2019 dollars).<sup>130</sup>

The Department estimates that annual cost savings associated with this rule would be \$480.8 million (\$447.2 million in increased clarity + \$33.6 million in avoided litigation costs).

### 3. Other Cost Savings and Benefits

Removing uncertainty improves labor market efficiency by reducing deadweight loss. As discussed in the need for rulemaking, the Department believes emerging and innovative economic arrangements that benefit both workers and business require reasonable certainty regarding the worker's classification as an independent contractor. The current legal uncertainty may deter businesses from offering these arrangements or developing them in the first place.<sup>131</sup> If so, the result would be economic deadweight loss: Legal uncertainty prevents mutually beneficial independent contractor arrangements. This proposed rule may produce cost savings by reducing deadweight loss. Nonetheless, due to the abundance of variables at play, the Department has not attempted to quantify the precise amount of that reduction. The Department invites data and comments on this topic.

By decreasing uncertainty and thus potentially opening new opportunities for firms, this proposed rule may encourage companies to hire independent contractors whom they otherwise would not have hired. Eisenach (2010) outlines the potential costs of curtailing independent contracting.<sup>132</sup> If independent contracting is expanded due to this rule, this could generate benefits that may include:

- Increased job creation and small business formation.

- Increased competition and decreased prices.

- A more flexible and dynamic work force, where workers are able to more easily move to locations or to employers where their labor and skills are needed.

Eisenach explains several channels through which these efficiency gains may be achieved. First, by avoiding some fixed employment costs, it is easier for firms to adjust their labor needs based on fluctuations in demand. Second, by using pay-for-preference, independent contractors are incentivized to increase production and quality. Third, "contracting can be an important mechanism for overcoming legal and regulatory barriers to economically efficient employment arrangements." The analysis of these benefits assume that businesses, especially in other industries, would like to increase their use of independent contractors, but have refrained from doing so because of uncertainty regarding who can appropriately be engaged as an independent contractor under the FLSA. Conversely, significant use of independent contractors may not be suitable for all industries, thus limiting the growth in its utilization.

The Department believes this rulemaking may also result in greater autonomy and job satisfaction for workers. Several surveys have shown that independent contractors have high job satisfaction.<sup>133</sup> Using the CWS, which only considers primary, active contractors, the Department estimates that of independent contractors with valid responses, 83 percent prefer their current arrangement rather than being an employee, compared with only 9 percent who would prefer an employment arrangement (the remaining 8 percent responded that it depends). Additionally, the main reasons they work as independent contractors demonstrate that they enjoy the benefits of being an independent contractor: 31 percent enjoy being their own boss or the independence it allows, and 27 percent enjoy the scheduling flexibility.<sup>134</sup> Additionally, McKinsey Global Institute found that "[i]ndependent workers report higher levels of satisfaction on many aspects of their work life than traditional workers."<sup>135</sup> The McKinsey Global

<sup>128</sup> The 56 cases used for this analysis were retrieved from Westlaw's Case Evaluator database using a keyword search for case summaries between 2012 and 2015 mentioning the terms "FLSA" and "fees." This was not limited to cases associated with independent contracting. Although the initial search yielded 64 responsive cases, the Department excluded one duplicate case, one case resolving litigation costs through a confidential settlement agreement, and six cases where the defendant employer(s) ultimately prevailed. Because the FLSA only entitles prevailing plaintiffs to litigation cost awards, information about litigation costs was only available for the remaining 56 FLSA cases that ended in settlement agreements or court verdicts favoring the plaintiff employees.

<sup>129</sup> These totals may underestimate total litigation costs because some FLSA cases are heard in state court and thus were not captured by PACER; some filings are resolved before litigation or by alternative dispute resolution; and some attorneys representing FLSA plaintiffs may take a contingency fee atop their statutorily awarded fees and costs.

<sup>130</sup> Using the median litigation cost, rather than the mean, results in a value of \$122,341 (2019 dollars) per case, which for the estimated 47 annual cases produces a total annual litigation cost savings of \$5.7 million. However, the median values do not adequately capture the magnitude of the impact resulting from large-scale litigation cases that are expected to benefit from the clarity provided in this proposed rule. Therefore, the mean average is used for this analysis.

<sup>131</sup> See Pivateau, *supra* note 26, at 628 ("The continued demand for innovative work solutions requires a new classification test. Without clarification, parties will be unwilling to engage in new or innovative work arrangements."); see also Hollrah and Hollrah, "The Time Has Come for Congress to Finish Its Work on Harmonizing the Definition of 'Employee,'" 26 J. L. & Pol'y 439 (2018), <https://brooklynworks.brooklaw.edu/jlp/vol26/iss2/1/>.

<sup>132</sup> J. Eisenach, "The Role of Independent Contractors in The U.S. Economy," Navigant Economics (2010), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1717932](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1717932).

<sup>133</sup> See, e.g., "The State of Independence in America," MBO Partners (2019) <https://www.mbppartners.com/state-of-independence/>.

<sup>134</sup> The Department used PES26IC to identify preferred work arrangement and PES26IR to identify the reason they work as an independent contractor.

<sup>135</sup> McKinsey Global Institute, *supra* note 74 at 11. A 2009 Pew survey similarly found that self-

Institute examined workers who work independently by choice and those who do so by necessity (such as needing supplemental income) and found that both groups report being happy with the flexibility and autonomy of their work.<sup>136</sup> Similarly, Kelly Services found that “free agents”—*i.e.*, workers who “derive their primary income from independent work and actively prefer it”—report higher satisfaction than traditional workers concerning overall employment situation; work-life balance; opportunities to expand skills; and opportunities to advance career.<sup>137</sup>

By clarifying that control and opportunity for profit are the core economic reality factors, this proposed rule is likely to encourage the creation of independent contractor jobs that provide autonomy and entrepreneurial opportunities that workers find satisfying. For the same reason, this proposed rule likely would diminish the incidence of independent contractor jobs that lack these desired characteristics. Thus, the Department expects this NPRM, if finalized, to result in more independent contractor opportunities which bring with them autonomy and job satisfaction. The benefits of worker autonomy and satisfaction obviously “are difficult or impossible to quantify,” but they nonetheless merit consideration.

employed workers are “significantly more satisfied with their jobs than other workers.” Rich Morin, “Job Satisfaction among the Self-Employed,” Pew Research Center, (September 2009), <http://pewsocialtrends.org/pubs/743/job-satisfaction-highest-among-self-employed>. In particular, 39 percent of self-employed workers reported being “completely satisfied” with their jobs, compared with 28 percent of employees. *Id.*

<sup>136</sup> McKinsey Global Institute, *supra* note 74 at 10. The McKinsey survey found that, while “those working independently out of necessity report being happier with the flexibility and content of the work,” they also report being “less satisfied with their level of income level and their income security.” *Id.* This rulemaking is unlikely to negatively impact the average income level of such workers by encouraging independent contractor opportunities because there is no statistical evidence that independent contractor earn less than employees. To the contrary and as discussed above, there are data indicating that independent contractors, on average, may earn higher hourly wages than employees. Nor is rulemaking likely to negatively impact workers’ income security, on average. The Department believes income security is best achieved by removing barriers that prevent laid-off Americans from finding paid work, including as independent contractors. See 151 Ph.D. Economists and Political Scientists in California, “Open Letter to Suspend California AB–5” (April 14, 2020). This lesson may be all the greater in light of the COVID–19 emergency.

<sup>137</sup> Kelly Services, “Agents of Change” (2015), [https://www.kellyservices.com/global/siteassets/3-kelly-global-services/uploadedfiles/3-kelly\\_global\\_services/content/sectionless\\_pages/kocg1047720freagent20whitepaper20210x21020final2.pdf](https://www.kellyservices.com/global/siteassets/3-kelly-global-services/uploadedfiles/3-kelly_global_services/content/sectionless_pages/kocg1047720freagent20whitepaper20210x21020final2.pdf).

### G. Regulatory Alternatives

When proposing an economically significant rule, Executive Order 12866 requires agencies to conduct “[a]n assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation.”<sup>138</sup> Here, in addition to “the alternative of not regulating,”<sup>139</sup> the Department considered three alternatives to the proposed rule, listed below from least to most restrictive of independent contracting:<sup>140</sup>

(1) Codification of the common law control test, which applies in distinguishing between employees and independent contractors under various other federal laws;<sup>141</sup>

(2) codification of the traditional six-factor “economic reality” balancing test, as recently articulated in WHD Opinion Letter FLSA2019–6; and

(3) codification of the “ABC” test, as adopted by the California Supreme Court in *Dynamex Operations W., Inc. v. Superior Court*, 416 P.3d 1 (Cal. 2018).<sup>142</sup>

Although the Department recognizes that legal limitations prevent some of these alternatives from being actionable, the Department nonetheless presents them as regulatory alternatives in accord with OMB guidance.<sup>143</sup> These three regulatory alternatives are analyzed below in qualitative terms, due to data constraints and inherent uncertainty in

<sup>138</sup> Exec. Order No. 12866 § 6(a)(3)(C)(iii), 58 FR 51741.

<sup>139</sup> Exec. Order No. 12866 § 1, 58 FR 51735.

<sup>140</sup> OMB guidance advises that, where possible, agencies should analyze at least one “more stringent option” and one “less stringent option” to the proposed approach. OMB Circular A–4 at 16.

<sup>141</sup> See 26 U.S.C. 3121(d)(2) (generally defining the term “employee” under the Internal Revenue Code as “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee”); 42 U.S.C. 410(j) (similarly defining “employee” under the Social Security Act); see also, e.g., *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 751 (1989) (applying “principles of general common law of agency” to determine “whether . . . work was prepared by an employee or an independent contractor” under the Copyright Act of 1976); *Darden*, 503 U.S. 318 (holding that “a common-law test” should resolve employee/independent contractor disputes under ERISA).

<sup>142</sup> See also *Hargrove v. Sleepy’s, LLC*, 106 A.3d 449, 465 (N.J. 2015) (extending the ABC test to state wage claims in New Jersey).

<sup>143</sup> OMB Circular A–4 advises that agencies “should discuss the statutory requirements that affect the selection of regulatory Approach. If legal constraints prevent the selection of a regulatory action that best satisfies the philosophy and principles of Executive Order 12866, [agencies] should identify these constraints and estimate their opportunity cost. Such information may be useful to Congress under the Regulatory Right-to-Know Act.”

measuring the exact stringency of multi-factor legal tests and likely responses from the regulated community. The Department welcomes comment on these regulatory alternatives, as well as suggestions regarding any other potential alternatives.

#### 1. Codifying a Common Law Control Test

The least stringent alternative to the proposed rule’s streamlined “economic reality” test would be to adopt a common law control test, as is generally used to determine independent contractor classification questions arising under the Internal Revenue Code and various other federal laws.<sup>144</sup> The overarching focus of the common law control test is “the hiring party’s right to control the manner and means by which [work] is accomplished,” *Reid*, 490 U.S. at 751, but the Supreme Court has explained that “other factors relevant to the inquiry [include] the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party’s discretion over when and how long to work; the method of payment; the hired party’s role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.” *Id.* at 751–52.

Although the common law control test considers many of the same factors as those identified in the proposed rule’s “economic reality” test (e.g., skill, length of the working relationship, the source of equipment and materials, *etc.*), courts generally recognize that, because of its focus on control, the common law test is more permissive of independent contracting arrangements than the economic reality test, which more broadly examines the economic dependence of the worker. See, e.g., *Diggs v. Harris Hospital-Methodist, Inc.*, 847 F.2d 270, 272 n. 1 (5th Cir. 1988) (observing that “[t]he ‘economic realities’ test is a more expansive standard for determining employee status” than the common law control test). Thus, if a common law control test determined independent contractor status under the FLSA, it is possible that some workers presently classified as FLSA employees could be reclassified as independent contractors, increasing the overall number of independent

<sup>144</sup> See *supra* note 141.

contractors and reducing the overall number of employees. The Department is unable to estimate the exact magnitude of such a reclassification effect, but believes that the vast majority of FLSA employees would remain FLSA employees under a common law control test.<sup>145</sup>

Codifying a common law control test would create a simpler legal regime for regulated entities interested in receiving services from an independent contractor, thereby reducing confusion, compliance costs, and legal risk for entities interested in doing business with independent contractors. Entities would not, for example, have to understand and apply one employment classification standard for tax purposes and a different employment classification standard for FLSA purposes. Thus, adopting the common law control test would likely increase perpetual cost savings for regulated entities attributable to improved clarity and reduced litigation as compared to the proposed rule. It could, on the other hand, impose burdens on workers who might prefer to be employees subject to FLSA protections.

The Department notes that the Supreme Court has interpreted the “suffer or permit” language in section 3(g) of the FLSA as demanding a broader definition of employment than that which exists under the common law. *See, e.g., Darden*, 503 U.S. at 326; *Portland Terminal Co.*, 330 at 150–51. Accordingly, the Department believes it is legally constrained from adopting the common law control test absent Congressional legislation to amend the FLSA.

## 2. Codifying the Six-Factor “Economic Reality” Balancing Test

As discussed earlier in section II(B), WHD has long applied a multifactor “economic reality” balancing test to distinguish between employees and independent contractors in enforcement actions and subregulatory guidance. Recently articulated in WHD Opinion Letter FLSA2019–6, the six factors presently considered in WHD’s multifactor balancing test are as follows:

- (1) The nature and degree of the potential employer’s control;
- (2) The permanency of the worker’s relationship with the potential employer;

<sup>145</sup> As discussed earlier in section IV(D)(7), a review of federal appellate case law since 1975 shows that the classification outcome of almost every FLSA employee/independent contractor dispute has aligned with the court’s specific finding on the control factor. Thus, adoption of a common law control test would be unlikely to alter most FLSA worker classifications, including those close enough to merit federal appellate litigation under the economic reality test.

(3) The amount of the worker’s investment in facilities, equipment, or helpers;

(4) The amount of skill, initiative, judgment, or foresight required for the worker’s services;

(5) The worker’s opportunities for profit or loss; and

(6) The extent of integration of the worker’s services into the potential employer’s business.

WHD Opinion Letter FLSA2019–6 at 4 (citing *Rutherford*, 331 U.S. at 730, and *Silk*, 331 U.S. at 716).

The Department believes that the six-factor balancing test (as articulated in WHD Opinion Letter FLSA2019–6) is neither more nor less permissive of independent contractor relationships as compared to the streamlined test proposed in this rulemaking. Both tests describe the “economic dependence” of the worker at issue as the ultimate inquiry of the test; both emphasize the primacy of actual practice over contractual or theoretical possibilities (*i.e.*, the “economic reality” of the work arrangement); and both evaluate the same set of underlying factors, notwithstanding an emphasis and consolidation of certain factors under the streamlined test. Notably, like § 795.105(d)(1)(i) of the proposed rule, WHD Opinion Letter FLSA2019–6 advised that certain safety measures and quality control standards do not constitute “control” indicative of an FLSA employment relationship. *See id.* at 8 n. 4.

Although codifying this six-factor balancing test would thus impose a comparably stringent legal standard on the regulated community, the Department believes, as explained earlier in section III, that the six-factor balancing test presently used by WHD and most courts would benefit from clarification, sharpening, and streamlining. For this reason, the Department believes that codifying such a test would not yield the perpetual benefits and cost savings discussed earlier in this analysis, such as improved clarity and reduced FLSA litigation. Additionally, the Department does not believe that codifying the six-factor balancing test would reduce initial regulatory familiarization costs or provide per-contract clarity cost savings, as interested establishments and independent contractors will likely spend the same amount of time learning about any new regulatory language addressing independent contractor status under the FLSA (no regulatory guidance on the topic currently exists).

## 3. Codifying California’s “ABC” Test

The most stringent regulatory alternative to the Department’s

proposed rule would be to codify the “ABC” test recently adopted under California’s state wage and hour law to distinguish between employee/independent contractor statuses.<sup>146</sup> As described by the California Supreme Court in *Dynamex*, “[t]he ABC test presumptively considers all workers to be employees, and permits workers to be classified as independent contractors only if the hiring business demonstrates that the worker in question satisfies *each* of three conditions: (a) That 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 the work and in fact; *and* (b) that the worker performs work that is outside the usual course of the hiring entity’s business; *and* (c) that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.” 416 P.3d at 34 (emphasis in original).<sup>147</sup> In justifying the adoption of such a stringent test, the *Dynamex* court noted the existence of an “exceptionally broad suffer or permit to work standard” in California’s wage and hour statute, *id.* at 31,<sup>148</sup> as well as “the more general principle that wage orders are the type of remedial legislation that must be liberally construed in a manner that

<sup>146</sup> *See Dynamex*, 416 P.3d 1; Assembly Bill (“A.B.”) 5, Ch. 296, 2019–2020 Reg. Sess. (Cal. 2019) (codifying the ABC test articulated in *Dynamex*); A.B. 2257, Ch. 38, 2019–2020 Reg. Sess. (Cal. 2020) (retroactively exempting certain professions, occupations, and industries from the ABC test that A.B. 5 had codified). The ABC test originated in state unemployment insurance statutes, but some state courts and legislatures have recently extended the test to govern employee/independent contractor disputes under state wage and hour laws. *See Keith Cunningham-Parmeter, Gig-Dependence: Finding the Real Independent Contractors of Platform Work*, 39 N. Ill. U. L. Rev. 379, 408–11 (2019) (discussing the origins and recent expansion of the ABC test).

<sup>147</sup> California’s ABC test is slightly more stringent than versions of the ABC test adopted (or presently under consideration) in other states. For example, New Jersey provides that a hiring entity may satisfy the ABC test’s “B” prong by establishing either: (1) That the work provided is outside the usual course of the business for which the work is performed, or (2) that the work performed is outside all the places of business of the hiring entity. N.J. Stat. Ann. § 43:21–19(i)(6)(A–C). The Department has chosen to analyze California’s ABC test as a regulatory alternative because businesses subject to multiple standards, including nationwide businesses, are likely to comply with the most demanding standard if they wish to make consistent classification determinations.

<sup>148</sup> *See* Cal. Code Regs., tit. 8, § 11090, subd. 2(D) (“‘Employ’ means to engage, suffer, or permit to work.”). The *Dynamex* court noted that California’s adoption of the “suffer or permit to work” standard predated the enactment of the FLSA and was therefore “not intended to embrace the federal economic reality test” that subsequently developed. 416 P.3d at 35.



serves its remedial purposes.” *Id.* at 32.<sup>149</sup>

On its face, California’s ABC test is far more restrictive of independent contracting arrangements than any formulation of an “economic reality” balancing test, including the proposed rule. Whereas no single factor necessarily disqualifies a worker from independent contractor status under an economic reality test, *each* of the ABC test’s three factors may alone disqualify the worker from independent contractor status. Thus, adoption of an ABC test to govern independent contractor status under the FLSA would directly result in a large-scale reclassification of many workers presently classified as independent contractors into FLSA-covered employees. This reclassification effect would be particularly disruptive in industries that depend on independent contracting arrangements within the “usual course of the hiring entity’s business,” such as transportation, residential construction, cable installation, *etc.* While some independent contractors might benefit from reclassification by newly receiving overtime pay and/or a guaranteed minimum wage, these workers might also experience a reduction in work hours or diminished scheduling flexibility as their new employers attempt to avoid incurring additional expenses for overtime work. Others workers, particularly off-site workers who operate free from the business’ direct control and supervision, might see their work arrangements terminated by businesses unwilling or unable to assume the financial burden and legal risk of the FLSA’s overtime pay requirement. Some businesses in California responded to the increased legal risk of treating certain workers as independent contractors under the ABC test by terminating their relationships with workers,<sup>150</sup> thereby eliminating some of the flexible work arrangements sought, for example, by parents and others who must balance work and

family obligations.<sup>151</sup> The Department believes adopting the ABC test as the FLSA’s generally applicable standard for distinguishing employees from independent contractors would be unduly restrictive and disruptive to the economy. The fact that California recently enacted numerous exemptions to the ABC test highlights the test’s limitations as a possible alternative under the FLSA.<sup>152</sup>

In any event, the Department believes it is legally constrained from adopting California’s ABC test because the Supreme Court has instituted the economic reality test as the relevant standard for determining workers’ classification under the FLSA as an employee or independent contractor. *See Tony & Susan Alamo*, 471 U.S. at 301 (“The test of employment under the Act is one of ‘economic reality.’”); *Whitaker House*, 366 U.S. at 33 (1961) (“‘economic reality’ rather than ‘technical concepts’ is . . . the test of employment” under the FLSA) (citing *Silk*, 331 U.S. at 713; *Rutherford Food*, 331 U.S. at 729)).

The California Supreme Court explicitly recognized that the ABC test defines “employee” more broadly than the FLSA when it explained that the ABC test rests on a “standard in California wage orders [that] was not intended to embrace the [FLSA’s] economic reality test” and was instead “intended to provide broader protection than that accorded workers under the [FLSA] standard.” *Dynamex*, 416 P.3d at 35.<sup>153</sup> Moreover, the Supreme Court has stated that the existence of employment relationships under the FLSA “does not depend on such isolated factors” as the three independently determinative factors in the ABC test, “but rather upon the circumstances of the whole activity.” *Rutherford Food*, 331 U.S. at

730. Because the ABC test is therefore inconsistent with Supreme Court precedent interpreting the FLSA, the Department concludes it could not adopt the ABC test.

Although the ABC test is “a simpler, more structured test” than a multifactor balancing test and would likely lead to more consistent classification outcomes, *Dynamex*, 416 P.3d at 34, legal constraints and the disruptive economic effects of adopting such a stringent standard advises against its adoption in the FLSA context. As mentioned earlier, the Department has engaged in this rulemaking to clarify the existing standard, not to radically transform it.

#### H. Summary of Impacts

In summary, the Department believes that this rule will increase clarity regarding whether a worker is classified as an employee or an independent contractor under the FLSA. This clarity could result in an increased use of independent contractors. The costs and benefits to a worker being classified as an independent contractor are discussed throughout this analysis, and are summarized below.

The Department believes that there are real benefits to the use of independent contractor status, for both workers and employers. Independent contractors generally have greater autonomy and more flexibility in their hours, providing them more control over the management of their time. The use of independent contracting for employers allows for a more flexible and dynamic workforce, where workers provide labor and skills where and when they are needed. Independent contractors may more easily work for multiple companies simultaneously, have more control over their labor-leisure balance, and more explicitly define the nature of their work. Independent contractors also appear to have higher job satisfaction.

An increase in the number of job openings for independent contractors can also have benefits for the economy as a whole. Increased job creation and enhanced flexibility in work arrangements are critical benefits during periods of economic uncertainty, such as the current COVID-19 pandemic.

There are unique challenges that face independent contractors compared to employees subject to the FLSA. Independent contractors are not subject to the protections of the FLSA, such as minimum wage and overtime pay. Independent contractors generally do not receive the same employer-provided benefits as employees, such as health insurance, retirement contributions, and

<sup>149</sup> See Cal. Code Regs., tit. 8, § 11090, subd. 2(D) (“‘Employ’ means to engage, suffer, or permit to work.”).

<sup>150</sup> See, e.g., Marc Tracy and Kevin Draper, “Vox Media to Cut 200 Freelancers, Citing California Gig-Worker Law,” *New York Times* (Dec. 16, 2019), [www.nytimes.com/2019/12/16/business/media/vox-media-california-job-cuts.html](http://www.nytimes.com/2019/12/16/business/media/vox-media-california-job-cuts.html); Dawn Kawamoto, “Exclusive: Fast-growing S.F. company to exit market as result of state’s new gig worker law,” *San Francisco Business Times* (Jan. 3, 2020), [www.bizjournals.com/sanfrancisco/news/2020/01/03/exclusive-fast-growing-s-f-company-to-exit-market.html](http://www.bizjournals.com/sanfrancisco/news/2020/01/03/exclusive-fast-growing-s-f-company-to-exit-market.html); Sophia Bollag and Dale Kasler, “California Workers Blame New Labor Law for Lost Jobs. Lawmakers are Scrambling to Fix It,” *Sacramento Bee* (Feb. 10, 2020), [www.sacbee.com/news/politics-government/capitol-alert/article239822623.html](http://www.sacbee.com/news/politics-government/capitol-alert/article239822623.html).

<sup>151</sup> See, e.g., Elaine Pofeldt, “California’s AB-5 leaves Women Business Owners Reeling,” *Forbes* (Jan. 19, 2020), [www.forbes.com/sites/elainepofeldt/2020/01/19/californias-ab5-leaves-women-business-owners-reeling/#460fb6f05ef3](http://www.forbes.com/sites/elainepofeldt/2020/01/19/californias-ab5-leaves-women-business-owners-reeling/#460fb6f05ef3).

<sup>152</sup> See A.B. 2257, Ch. 38, 2019–2020 Reg. Sess. (Cal. 2020).

<sup>153</sup> The ABC test would define “employee” to include workers who have been held by the Supreme Court to be independent contractors under the economic reality test. For instance, under the ABC test, the term “employee” would include individuals who perform work that falls within the usual course of the hiring entity’s business, regardless of all other considerations. Even though transporting coal falls within a coal company’s usual course of business, the United States Supreme Court held in *Silk* that truck drivers hired by a coal company to transport coal were independent contractors rather than employees. 331 U.S. at 719. Similarly, the Court held in *Bartels* that musicians were independent contractors rather than employees of the music hall where they played, even though playing music falls within the music hall’s usual course of business. 332 U.S. at 130.

paid time off.<sup>154</sup> Independent contractors may have a higher tax liability than employees, as they are legally obligated to pay both the employee and employer shares of the Federal Insurance Contributions Act (FICA) taxes. However, economists recognize that payroll taxes generally are subtracted from the wage rate of employees. Employers also cover unemployment insurance and workers' compensation taxes for their employees. These costs are also components of businesses' worker costs, and employee wages are expected to reflect that accordingly. Independent contractors do not pay these taxes nor are they generally protected by these insurance programs, but there are private insurance companies that offer equivalent coverage.

Because the Department does not know how many workers may shift from employee status to independent contractor status, or how many people who were previously unemployed or out of the labor force will gain work as an independent contractor, these costs and benefits have not been quantified. The Department welcomes comments and data on these costs and benefits, and on how the prevalence of independent contractor relationships will change as a result of this proposed rule.

## VII. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act of 1980 (RFA), 5 U.S.C. 601 *et seq.*, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996, Public Law 104–121 (1996), requires federal agencies engaged in rulemaking to consider the impact of their proposals on small entities, consider alternatives to minimize that impact, and solicit public comment on their analyses. The RFA requires the assessment of the impact of a regulation on a wide range of small entities, including small businesses, not-for-profit organizations, and small governmental jurisdictions. Accordingly, the Department examined the regulatory requirements of the proposed rule to determine whether they would have a significant economic impact on a substantial number of small entities. Because both costs and cost savings are minimal for small business entities, the Department certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities.

The Department used the Small Business Administration size standards,

which determine whether a business qualifies for small-business status, to estimate the number of small entities.<sup>155</sup> The Department then applied these thresholds to the U.S. Census Bureau's 2012 Economic Census to obtain the number of establishments with employment or sales/receipts below the small business threshold in the industry.<sup>156</sup> These ratios of small to large establishments were then applied to the more recent 2017 SUBS data.<sup>157</sup> The Department estimated there are 6.4 million small establishments or governments.<sup>158</sup>

The per-entity cost for small business employers is the regulatory familiarization cost of \$54.74, or the fully loaded mean hourly wage of a Compensation, Benefits, and Job Analysis Specialist multiplied by one hour. The per-entity rule familiarization cost for independent contractors, some of whom would be small businesses, is \$11.59, or the fully loaded mean hourly wage of independent contractors in the CWS (\$46.36) multiplied by 0.25 hour.

The cost savings due to increased clarity estimated per year for each small business employer is \$18.25, or the fully loaded mean hourly wage of a Compensation, Benefits, and Job Analysis Specialist multiplied by 0.33 hours. The cost savings due to increased clarity for each independent contractor, some of whom would be a small business, is \$3.86 per year, or the fully loaded mean hourly wage of independent contractors in the CWS multiplied by 0.83 hours. Because regulatory familiarization is a one-time cost and the cost savings from clarity recur each year, the Department expects cost savings to outweigh regulatory familiarization costs in the long run. Because both costs and cost savings are minimal for small business entities, and well below one percent of their gross annual revenues, which is typically at least \$100,000 per year for the smallest businesses, the Department certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities.

There is some evidence that small firms use independent contractors for a greater proportion of their workforce

than large firms.<sup>159</sup> If so, then it may be reasonable to assume that the increased use of independent contractors may also favor smaller companies. In which case, costs and benefits and cost savings may be larger for these small firms. Because benefits and cost savings are expected to outweigh costs, the Department does not expect this rule will result in an undue hardship for small businesses. The Department requests comments and data on this finding, including the numbers of small entities affected by this rule and the compliance costs and associated cost savings and benefits.

## VIII. Unfunded Mandates Reform Act Analysis

The Unfunded Mandates Reform Act of 1995 (UMRA)<sup>160</sup> requires agencies to prepare a written statement for rules with a federal mandate that may result in increased expenditures by state, local, and tribal governments, in the aggregate, or by the private sector, of \$156 million (\$100 million in 1995 dollars adjusted for inflation) or more in at least one year.<sup>161</sup> This statement must: (1) identify the authorizing legislation; (2) present the estimated costs and benefits of the rule and, to the extent that such estimates are feasible and relevant, its estimated effects on the national economy; (3) summarize and evaluate state, local, and tribal government input; and (4) identify reasonable alternatives and select, or explain the non-selection, of the least costly, most cost-effective, or least burdensome alternative.

### A. Authorizing Legislation

This proposed rule is issued pursuant to the Fair Labor Standards Act, 29 U.S.C. 201, *et seq.*

### B. Assessment of Costs and Benefits

For purposes of the UMRA, this rule includes a federal mandate that is expected to result in increased expenditures by the private sector of more than \$156 million in at least one year, but will not result in increased expenditures by state, local, and tribal governments, in the aggregate, of \$156 million or more in any one year.

Based on the cost analysis from this proposed rule, the Department determined that the proposed rule will result in Year 1 total costs for state and local governments totaling \$1.7 million, all for regulatory familiarization. There

<sup>155</sup> SBA, Summary of Size Standards by Industry Sector, 2017, [www.sba.gov/document/support-table-size-standards](http://www.sba.gov/document/support-table-size-standards).

<sup>156</sup> The 2012 data are the most recently available with revenue data.

<sup>157</sup> For this analysis, the Department excluded independent contractors who are not registered as small businesses, and who are generally not captured in the SUBS, from the calculation of small establishments.

<sup>158</sup> The number of small governments was calculated based on data from the 2017 Census of Governments.

<sup>154</sup> In some situations, independent contractors may be provided with benefits similar to those provided to employees.

<sup>159</sup> Lim et al, *supra* note 61 at 51.

<sup>160</sup> See 2 U.S.C. 1501.

<sup>161</sup> Calculated using growth in the Gross Domestic Product deflator from 1995 to 2019. Bureau of Economic Analysis, Table 1.1.9. Implicit Price Deflators for Gross Domestic Product.

will be no additional costs incurred in subsequent years.

The Department determined that the proposed rule will result in Year 1 total costs for the private sector of \$369.2 million, all of them incurred for regulatory familiarization. The Department included all independent contractors in the private sector total regulatory familiarization costs. There will be no additional costs incurred in subsequent years.

UMRA requires agencies to estimate the effect of a regulation on the national economy if such estimates are reasonably feasible and the effect is relevant and material.<sup>162</sup> However, OMB guidance on this requirement notes that such macroeconomic effects tend to be measurable in nationwide econometric models only if the economic effect of the regulation reaches 0.25 percent to 0.5 percent of Gross Domestic Product (GDP), or in the range of \$53.6 billion to \$107.2 billion (using 2019 GDP).<sup>163</sup> A regulation with a smaller aggregate effect is not likely to have a measurable effect in macroeconomic terms, unless it is highly focused on a particular geographic region or economic sector, which is not the case with this proposed rule.

The Department's PRIA estimates that the total costs of the proposed rule will be \$369.2 million. Given OMB's guidance, the Department has determined that a full macroeconomic analysis is not likely to show that these costs would have any measurable effect on the economy.

#### *C. Least Burdensome Option Explained*

This Department believes that it has chosen the least burdensome but still cost-effective methodology to clarify its interpretation of the FLSA's distinction between employees and independent contractors. Although the proposed regulation would impose costs for regulatory familiarization, the Department believes that its proposal would reduce the overall burden on organizations by simplifying and clarifying the analysis for determining whether a worker is classified as an employee or an independent contractor under the FLSA. The Department believes that, after familiarization, this rule will reduce the time spent by organizations to determine whether a worker is an independent contractor. Additionally, revising the Department's guidance to provide more clarity could

promote innovation and certainty in business relationships.

#### **IX. Effects on Families**

The undersigned hereby certifies that the proposed rule would not adversely affect the well-being of families, as discussed under section 654 of the Treasury and General Government Appropriations Act, 1999.

#### **List of Subjects**

##### *29 CFR Part 780*

Agriculture, Child labor, Wages.

##### *29 CFR Part 788*

Forests and forest products, Wages.

##### *29 CFR Part 795*

Employment, Wages.

Signed at Washington, DC, this 18th day of September, 2020.

**Cheryl M. Stanton,**

*Administrator, Wage and Hour Division.*

For the reasons set out in the preamble, the Department of Labor proposes to amend Title 29 of the Code of Federal Regulations parts 780 and 788 and add part 795, as follows:

#### **PART 780—EXEMPTIONS APPLICABLE TO AGRICULTURE, PROCESSING OF AGRICULTURAL COMMODITIES, AND RELATED SUBJECTS UNDER THE FAIR LABOR STANDARDS ACT**

■ 1. The authority citation for part 780 continues to read as follows:

**Authority:** Secs. 1–19, 52 Stat. 1060, as amended; 29 U.S.C. 201–219.

■ 2. Amend § 780.330 by revising paragraph (b) as follows:

##### **§ 780.330 Sharecroppers and tenant farmers.**

\* \* \* \* \*

(b) In determining whether such individuals are employees or independent contractors, the criteria laid down in §§ 795.100 through 795.110 of this chapter are used.

\* \* \* \* \*

#### **PART 788—FORESTRY OR LOGGING OPERATIONS IN WHICH NOT MORE THAN EIGHT EMPLOYEES ARE EMPLOYED**

■ 3. The authority citation for part 788 continues to read as follows:

**Authority:** Secs. 1–19, 52 Stat. 1060, as amended; 29 U.S.C. 201–219.

■ 4. Amend § 788.16 by revising paragraph (a) as follows:

#### **§ 788.16 Employment relationship.**

(a) In determining whether individuals are employees or independent contractors, the criteria laid down in §§ 795.100 through 795.110 of this chapter are used.

\* \* \* \* \*

■ 5. Add part 795 to read as follows:

#### **PART 795—EMPLOYEE OR INDEPENDENT CONTRACTOR CLASSIFICATION UNDER THE FAIR LABOR STANDARDS ACT**

Sec.

795.100 Introductory statement.

795.105 Determining employee and independent contractor classification under the FLSA.

795.110 Primacy of actual practice.

795.115 Severability.

**Authority:** 52 Stat. 1060, as amended; 29 U.S.C. 201–219.

##### **§ 791.100 Introductory statement.**

This part contains the Department of Labor's general interpretations of the text governing individuals' classification as employees or independent contractors under the Fair Labor Standards Act (FLSA or Act). See 29 U.S.C. 201–19. The Administrator of the Wage and Hour Division will use these interpretations to guide the performance of his or her duties under the Act, and intends the interpretations to be used by employers, employees, and courts to understand employers' obligations and employees' rights under the Act. To the extent that prior administrative rulings, interpretations, practices, or enforcement policies relating to classification as an employee or independent contractor under the Act are inconsistent or in conflict with the interpretations stated in this part, they are hereby rescinded. The interpretations stated in this part may be relied upon in accordance with section 10 of the Portal-to-Portal Act, 29 U.S.C. 251–262, notwithstanding that after any such act or omission in the course of such reliance, any such interpretation in this part "is modified or rescinded or is determined by judicial authority to be invalid or of no legal effect." 29 U.S.C. 259.

##### **§ 795.105 Determining employee and independent contractor classification under the FLSA.**

(a) *Independent contractors are not employees under the Act.* An individual who renders services to a potential employer—i.e., a putative employer or alleged employer—as an independent contractor is not that potential employer's employee under the Act. As such, sections 6, 7, and 11 of the Act, which impose obligations on employers

<sup>162</sup> See 2 U.S.C. 1532(a)(4).

<sup>163</sup> According to the Bureau of Economic Analysis, 2019 GDP was \$21.43 trillion. [https://www.bea.gov/system/files/2020-02/gdp4q19\\_2nd\\_0.pdf](https://www.bea.gov/system/files/2020-02/gdp4q19_2nd_0.pdf).

regarding their employees, are inapplicable. Accordingly, the Act does not require a potential employer to pay an independent contractor either the minimum wage or overtime pay under sections 6 or 7. Nor does section 11 of the Act require a potential employer to keep records regarding an independent contractor's activities.

(b) *Economic dependence as the ultimate inquiry.* An "employee" under the Act is an individual whom an employer suffers, permits, or otherwise employs to work. 29 U.S.C. 203(e)(1), (g). An employer suffers or permits an individual to work as an employee if, as a matter of economic reality, the individual is economically dependent on that employer for work. *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 727 (1947); *Bartels v. Birmingham*, 332 U.S. 126, 130 (1947). An individual is an independent contractor, as distinguished from an "employee" under the Act, if the individual is, as a matter of economic reality, in business for him- or herself.

(c) *Determining economic dependence.* The economic reality factors in paragraph (d) of this section guide the determination of whether the relationship between an individual and a potential employer is one of economic dependence and therefore whether an individual is properly classified as an employee or independent contractor. These factors are not exhaustive, and no single factor is dispositive. However, the two core factors listed in paragraph (d)(1) of this section are the most probative as to whether or not an individual is an economically dependent "employee," 29 U.S.C. 203(e)(1), and each is therefore afforded greater weight in the analysis than is any other factor. Given the greater weight afforded each of these two core factors, if they both point towards the same classification, whether employee or independent contractor, there is a substantial likelihood that is the individual's accurate classification. This is because other factors, which are less probative and afforded less weight, are highly unlikely, either individually or collectively, to outweigh the combined weight of the two core factors.

(d) *Economic reality factors*—(1) *Core factors*—(i) *The nature and degree of the individual's control over the work.* This factor weighs towards the individual being an independent contractor to the extent the individual, as opposed to the potential employer, exercises substantial control over key aspects of the performance of the work, such as by setting his or her own schedule, by

selecting his or her projects, and/or through the ability to work for others, which might include the potential employer's competitors. In contrast, this factor weighs in favor of the individual being an employee under the Act to the extent the potential employer, as opposed to the individual, exercises substantial control over key aspects of the performance of the work, such as by controlling the individual's schedule or workload and/or by directly or indirectly requiring the individual to work exclusively for the potential employer. 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 relationships) does not constitute control that makes the individual more or less likely to be an employee under the Act.

(ii) *The individual's opportunity for profit or loss.* This factor weighs towards the individual being an independent contractor to the extent the individual has an opportunity to earn profits or incur losses based on his or her exercise of initiative (such as managerial skill or business acumen or judgment) or management of his or her investment in or capital expenditure on, for example, helpers or equipment or material to further his or her work. While the effects of the individual's exercise of initiative and management of investment are both considered under this factor, the individual does not need to have an opportunity for profit or loss based on both for this factor to weigh towards the individual being an independent contractor. This factor weighs towards the individual being an employee to the extent the individual is unable to affect his or her earnings or is only able to do so by working more hours or more efficiently.

(2) *Other factors*—(i) *The amount of skill required for the work.* This factor weighs in favor of the individual being an independent contractor to the extent the work at issue requires specialized training or skill that the potential employer does not provide. This factor weighs in favor of the individual being an employee to the extent the work at issue requires no specialized training or skill and/or the individual is dependent upon the potential employer to equip him or her with any skills or training necessary to perform the job.

(ii) *The degree of permanence of the working relationship between the*

*individual and the potential employer.* This factor weighs in favor of the individual being an independent contractor to the extent the work relationship is by design definite in duration or sporadic, which may include regularly occurring fixed periods of work, although the seasonal nature of work by itself would not necessarily indicate independent contractor classification. This factor weighs in favor of the individual being an employee to the extent the work relationship is instead by design indefinite in duration or continuous.

(iii) *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 his or her work is a component of the potential employer's integrated production process for a good or service. This factor weighs in favor of an individual being an independent contractor to the extent his or her work is segregable from the potential employer's production process. This factor is different from the concept of the importance or centrality of the individual's work to the potential employer's business.

#### **§ 795.110 Primacy of actual practice.**

In 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, the individual is prevented from exercising such rights. Likewise, a business' contractual authority to supervise or discipline an individual may be of little relevance if in practice the business never exercises such authority.

#### **§ 795.115 Severability.**

If any provision of this part is held to be invalid or unenforceable by its terms, or as applied to any person or circumstance, or stayed pending further agency action, the provision shall be construed so as to continue to give the maximum effect to the provision permitted by law, unless such holding shall be one of utter invalidity or unenforceability, in which event the provision shall be severable from part 795 and shall not affect the remainder thereof.

[FR Doc. 2020-21018 Filed 9-24-20; 8:45 am]

BILLING CODE 4510-27-P