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Department of Labor Announces Proposed Regulations Regarding Worker Classification Under the FLSA

On September 22, the U.S. Department of Labor ("DOL") announced new proposed regulations regarding when workers can be classified as independent contractors under the Fair Labor Standards Act ("FLSA"). The FLSA requires companies to provide overtime pay to, and to keep certain records for, employees but not independent contractors. If finalized in its current form, the rule would set a DOL standard that largely eases companies' ability to classify workers as independent contractors under the FLSA and, if afforded deference by the courts, could impact the way that judges across the country analyze classification under the statute.

The issue of worker classification has made headlines recently amidst the rise of the so-called "gig economy," where individuals who might be classified as independent contractors have become central to the business models of many companies, including Uber and Postmates.

Citing existing confusion and inconsistency in the current application of the law, the DOL states that its new proposed regulations are intended to clarify the existing "economic reality" test which is used to determine whether a worker is "in business for themselves (an independent contractor)" or "is economically dependent on the potential employer for work" (an employee) for purposes of the FLSA. The new proposed standard looks primarily to two "core factors" instead of the five or more overlapping factors that have been used by most courts and the DOL previously.

The Two Core Factors

The first core factor is "the nature and degree of the worker's control over the work." The proposed regulations list a number of examples of an individual's substantial control, including being able to set his or her own work schedule, choose assignments, work with little or no supervision, and work for others, including a potential employer's competitors. The proposed rule clarifies, however, that requiring an individual to comply with contractual terms typical of business relationships (such as having insurance, meeting deadlines or quality control standards, meeting health and safety standards) is not an indicator of employee status.

The second core factor in the proposed rule is a "worker's opportunity for profit or loss." This is intended to efficiently combine the traditional "opportunity for profit or loss" factor with the "worker's investment" factor. The DOL proposes analyzing whether the worker 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. Here, the DOL rejects the notion that investments made by an independent contractor must be similar in amount to that made by the company engaging them. This core factor would weigh towards the individual being classified as an independent contractor if he or she has an opportunity for profit or loss. It weighs in favor of an employment relationship 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.

The DOL states that if both core factors point to the same finding, the analysis is largely complete, as "their combined weight is substantially likely to outweigh the combined weight of other factors that may point towards the opposite classification."

Additional Factors and Guidance

The regulations also identify three other factors that may serve as additional guideposts in the analysis if the first two do not point in the same direction. These include the amount of skill required for the work, the degree of permanence of the working relationship between the worker and the potential employer, and whether the work is part of an integrated unit of production. Notably, the proposed regulations seek to clarify that this final factor should consider "whether the work is part of an integrated unit of production," or "circumstances analogous to a production line" rather than "the extent to which services rendered are an integral part of the [potential employer's] business." It therefore seeks to downplay "whether an individual's work is important to a potential employer," which, the DOL states, "says nothing about whether the worker economically depends on that business for work." This may be particularly important to certain businesses, like Uber or Postmates which, as part of the "gig economy," serve primarily to "connect[] service providers with customers."

The DOL's notice of proposed rulemaking explains that no one factor is dispositive, and that "actual practices are entitled to greater weight than what may be contractually or theoretically possible."

What This Rule Change Could Mean for Employers

The DOL stated that it expects to finalize the rule by January 2021. Once the proposal is formally published on the Federal Register — which officials have said will likely happen either this week or next — the DOL will allow 30 days for comment.

Even if the rule change becomes final, employers must still comply with the myriad of other state and local laws applicable to independent contractor classifications in the jurisdictions where they engage workers. The proposed regulations do not govern the standards used by other federal agencies (*e.g.*, the IRS and NLRB), nor do they affect state laws, which are in some instances stricter in determining whether a company can classify workers as independent contractors. It therefore would remain possible for a service provider to be deemed an employee under one law (*e.g.*, the FLSA) and an independent contractor under another (*e.g.*, state labor law). Moreover, it remains to be seen how much, if any, deference federal courts across the country will give any final rule in light of the case law that has already been developed in each Circuit, or whether the rule will be challenged. To the extent that federal courts find that the rule is accorded deference, this rule could result in more uniformity in how federal courts across the country approach worker classification under the FLSA.

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