Articles + Publications | October 11, 2022

Locke Lord QuickStudy: Who's an Independent Contractor? Even More Regulatory Ping-Pong That Doesn't Change the Law

Locke Lord LLP

WRITTEN BY

Richard Reibstein

Earlier today, the Biden Administration's Labor Department issued a proposed regulation that seeks to define the worker classification test for independent contractor or employee status under the Fair Labor Standards Act (FLSA). The regulation, once finalized, would alter the test for IC status under the FLSA as last articulated by the Trump Administration, which had likewise changed the FLSA test for IC status previously issued by the Obama Administration. What does this mean legally for both workers and businesses who are currently classified as ICs? Not much, as explained below, since it is the courts that create law on this subject, not regulatory agencies. But as a practical matter, the issuance of the proposed regulation, once finalized, will likely give impetus to even more workers who currently receive 1099s to file class actions seeking minimum wage or overtime payments under federal and state laws. In anticipation of increased independent contractor misclassification litigation, prudent businesses should seek to minimize their exposure to IC misclassification liability in an effective two-pronged approach, as suggested below in our "Takeaway."

What Happened to the Trump Rule and Why Is the Biden Labor Department Issuing a New Regulation?

On January 7, 2021, shortly before the Trump Administration ended, the Labor Department issued a new Regulation regarding the test used to determine independent contractor status under the FLSA. As we stated in our blog post that day, the Trump regulation focused on two "core" factors: the nature and degree of control over the work and the worker's opportunity for profit or risk of loss. It then identified three other less probative "non-core" factors: the amount of skill required for the work, the degree of permanence of the working relationship between the worker and the employer, and whether the work is an integral part of the purported employer's business. This approach by the Trump Labor Department was premised on its conclusion that it was reciting the prevailing law as decided by the courts.

But soon after the Biden administration was sworn in, the Labor Department issued a Delay Rule and thereafter issued a Withdrawal Rule that withdrew the Trump Administration regulation. The Withdrawal Rule, issued on May 6, 2021, concluded that, "The Department believes that the [prior] Rule is inconsistent with the FLSA's text and purpose, and would have a confusing and disruptive effect on workers and businesses alike due to its departure from longstanding judicial precedent."

The Withdrawal Rule then addressed the differences between the Trump Administration's view of court decisions and the Biden Administration's reading of the same group of cases dealing with independent contractor status

under the FLSA. The Withdrawal Rule concluded that the prior rule focused too much on the issue of "control," thereby making the standard more like the "common law" test used by the courts under the tax code and less like the "economic realities" test used by judges under the FLSA for decades. As noted below, the new proposed rule essentially re-states the same thing about the Trump Rule.

But that Withdrawal Rule was later struck down by a federal district court on March 14 of this year, after it concluded the Biden Administration had issued the Delay and Withdrawal Rules without appropriate notice and comment periods and failed to consider alternatives before withdrawing the Trump Rule. As a result, the Biden Administration's Labor Department started the rule-making process once again, resulting in today's proposed regulation on the classification test for independent contractors.

What Does the New Rule Say and What Does It Mean?

Essentially, the proposed new regulation states that it seeks to restore the test used by the courts to determine IC status. As stated in the Executive Summary, instead of focusing on "core" and "non-core" factors that were the central considerations in the 2021 Trump Rule, the new regulation focuses on "the totality-of-the-circumstances analysis in which the economic reality factors are not assigned a predetermined weight and each factor is given full consideration." This approach, the Labor Department notes, is "aligned with the Department's decades-long approach (prior to the 2021 IC Rule) as well as circuit case law."

The biggest difference between the 2021 Trump Rule and the new Biden 2022 Rule appears to be the Biden Administration's effort to place more weight on one of the three "non-core" factors: whether the work is integral to the employer's business. This factor almost universally favors employee status, thereby causing many courts over the past decade to give it less weight than the other factors under consideration. The Biden Rule seeks to make that factor more important going forward, but it remains to be seen if the courts will change their view that that factor should be given less consideration than other factors.

Like the Trump 2021 Rule, the Biden 2022 Rule is a recitation of court decisions under the FLSA. Not surprisingly, it views the cases quite differently than did the prior Administration. In essence, the Trump Rule was akin to a legal brief to support independent contractor status, while the Biden 2022 Rule is more in the nature of a legal brief to support employee status, both focusing on a similar body of court decisions but viewing them from a different perspective.

The Biden 2022 Rule also gives greater weight to circumstances that the Trump 2021 Rule did not highlight. As noted in the Executive Summary, the Labor Department is now seeking to give greater weight in the "control" factor to "scheduling, supervision, price-setting, and the ability to work for others."

Here are the details of the new proposed regulation: Six factors in particular should be considered in determining the "economic reality" of the parties' relationship, which has, for decades, been the general focus of the courts:

1. Opportunity for profit or loss depending on managerial skill.
2. Investments by the worker and the purported employer.
3. Degree of permanence of the work relationship.
4. Nature and degree of control over the performance of the work and the economic aspects of the working relationship.

5. Extent to which the work is an integral part of the purported employer's business.
6. Skill and initiative of the worker.

The Biden 2022 Rule then also adds a seventh factor: "Additional Factors," which is described as any factors that "in some way indicate whether the worker is in business for themsel[ves], as opposed to being economically dependent on the employer for work."

The foregoing is essentially the entire regulation, with one paragraph descriptions of how the Labor Department believes the courts should apply each factor. This regulation is very similar to the factors recited by many courts, some of which refer to five factors and others that refer to six factors that are key to determining the economic realities of the parties.

Analysis

In sum, the new Biden 2022 Rule does little more than formally undo the Trump 2021 Rule and restore a totality-of-the-circumstances approach to determining IC status. Its focus on six factors (and a catch-all of additional factors) is hardly controversial, although the description of how the courts should apply each factor is tilted toward construing such factors in favor of employee status.

Prior to the issuance of the Biden 2022 Rule earlier today, many commentators wondered if the Labor Department would issue a rule similar to the very strict ABC test used in a few states, including California. That test does not consider the totality of the circumstances and favors a finding of employee status in an overwhelming number of cases. Plainly, the Biden Administration rejected that approach, which was included in a Democratic bill entitled Protecting the Right to Organize Act, also called the PRO Act. The rejection of that approach should be a relief to those who worried that the current administration would seek to strictly curtail the use of ICs.

In our July 5, 2022 blog post, we drew attention to what we regarded as a meaningful comment by Jessica Looman, the Acting Administrator of the Wage and Hour Division in the Labor Department, who has been nominated by President Biden to be the Wage and Hour Administrator. In a Labor Department blog post dated June 3, 2022, Looman, stated that, on the one hand, misclassified workers are denied basic workplace protections including rights to minimum wage and overtime, yet "[a]t the same time, we [at the Labor Department] recognize the important role legitimate independent contractors play in our economy."

Not surprisingly, that same language is used in the Executive Summary of the proposed new regulation: "[Workers who] are in business for themselves … play an important role in the economy and are commonly referred to by different names, including independent contractor, self-employed and freelancer." The next sentence of the Executive Summary may be even more reassuring to businesses and workers who wish to retain their independent contractor relationships: "This proposed rulemaking is not intended to disrupt the businesses of independent contractors who are, as a matter of economic reality, in business for themselves."

Is The Proposed New Regulation Meaningful From a Legal Perspective?

Not really. When the Trump Administration issued its regulation on independent contractor classification in early

January 2021, we noted in a January 6, 2021 blog post that "the regulation…would be 'much ado about (almost) nothing.'" We observed that, "unlike most regulations with hard and fast rules, the proposed regulation was in the nature of an administrative interpretation comprising the Labor Department's review of existing court decisions and its articulation of a preferred legal analysis … [that] courts would give little if any deference to." The Biden 2022 Rule is no different.

Regulations are not laws, and the courts, not regulatory bodies, have the final say on who qualifies as an independent contractor and who does not. While courts are supposed to give deference to valid regulations, that is not a given where regulations keep changing, especially where courts have already issued an abundance of decisions on a particular subject.

While the Biden 2022 Rule merely restores the "totality of circumstances" approach to determining IC status, there is yet another key reason why the proposed new rule is also rather limited in its application – it pertains to only one statute: the FLSA. The test for independent contractor status under the FLSA is not the same as the IC classification test under the Internal Revenue Code, ERISA, or the National Labor Relations Act. And, of course, each state has its own set of laws governing IC status and they contain an array of different tests, only a few of which use the test under the FLSA.

Nonetheless, from a practical perspective, the issuance of the new proposed regulation, once finalized, will likely have a meaningful impact. The issue of independent contractor status, particularly in the gig economy, has become so politicized in the past few years that even non-binding actions by administrative agencies have generated anxiety by most stakeholders (both businesses and workers alike) that the ground is yet again shifting below them. Thus, the practical effects of the Biden 2022 Rule cannot be minimized.

Takeaway

Companies utilizing ICs cannot help but be perplexed by the repeated back and forth at the Labor Department from one administration to the next on the issue of independent contractor classification. Businesses that use independent contractors should consider a two-step approach: (1) enhancing their compliance with federal and applicable state independent contractor laws to maximize independent contractor misclassification compliance in the event a state or federal workforce or tax agency conducts an audit; and (2) minimizing class actions by adding to their IC agreements a state-of-the-art arbitration provision with a class and collective action waiver or upgrading their existing arbitration agreements in view of developments in this area of the law.

IC relationships that are structured, documented, and implemented in a manner consistent with applicable law can serve to minimize IC misclassification liability. Companies should avoid quick fixes or one-size-all approaches, which tend to be ill-fitting and often backfire on the business. Instead, many businesses have created independent contractor relationships that are customized and sustainable using a process such as IC Diagnostics™ to restructure, re-document, and/or re-implement their IC relationships consistent with their existing business model.

At the same time, businesses should take steps to ensure they have an effectively-drafted arbitration clause in their IC agreements. As we stated in a blog post on this subject, "[w]hether an arbitration agreement in an independent contractor or employment setting will bar a class action depends as much of the wording in the arbitration clause as the applicable law, which is in flux and continues to evolve." That reality strongly suggests

that existing arbitration clauses used in independent contractor agreements should be reexamined and updated every few years.

RELATED INDUSTRIES + PRACTICES

- Independent Contractor Misclassification + Compliance
- Labor + Employment