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January 25, 2021

DOL delays effective date (86 FR 12535) and proposes final rule withdrawal (86 FR 14027)

To: Clients and Friends

From: David F. Dulock

Subject: Independent Contractor Status Under the Fair Labor Standards Act

In the January 7, 2021 issue of the *Federal Register* (86 FR 1168, *click here*), the U.S. Department of Labor (DOL) through its Wage and Hour Division (WHD) published a final rule revising its interpretation of independent contractor status under the Fair Labor Standards Act (FLSA) by the addition of part 795 to Title 29 of the Code of Federal Regulations, which addresses whether particular workers are employees or independent contractors under the FLSA. The FLSA does not define the term "independent contractor". The final rule is effective on ~~March 8, 2021~~ **May 7, 2021**.

Part 795 includes the following provisions:

- An introductory provision at §795.100 explaining the purpose and legal authority for part 795;
- 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 and 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 typically carry greater weight in the analysis, as well as three other factors that may serve as additional guides in the analysis;
- a provision at §795.110 advising that the parties' actual practice is more probative than what may be contractually or theoretically possible;
- six fact-specific examples at §795.115 that demonstrate how the economic reality factors listed in §795.105 (d) may be analyzed; and
- a severability provision at §795.120.

Below is a brief summary of the final rule taken from its *Federal Register* preamble.

§795.100 Introductory statement. This section explains that the interpretations in part 795 will guide WHD's performance of its duties under the FLSA and are intended to be used by employers, employees, and courts to understand employers' obligations and employees' rights under the FLSA. It further clarifies that employers may safely rely upon the interpretations in part 795 unless and until any such interpretation "is modified or rescinded or is determined by judicial authority to be invalid or of no legal effect." (quoting 29 U.S.C. §259). This section also rescinds prior administrative rulings, interpretations, practices, or enforcement policies relating to employee or independent contractor classification under the FLSA to the extent they are inconsistent or in conflict with part 795 interpretations. The DOL states that part 795 "concerns the distinction between employees and independent contractors solely for the purposes of the FLSA, and as such, would not affect the scope of employment under other Federal laws."

(4 pages)

§795.105 Determining employee and independent contractor classification under the FLSA. Subsection (a) explains that an independent contractor who renders services to a person is not an employee of that person under the FLSA, and that the FLSA's wage and hour requirements do not apply to a person's independent contractors. Subsection (a) also explains that the recordkeeping obligations for employers under the FLSA do not apply to a person's independent contractors.

Subsection (b) adopts the economic reality test to determine an individual's status as an employee or an independent contractor under the FLSA. Subsection (b) explains that an individual is an employee under the FLSA if, as a matter of economic reality, the individual is economically dependent on the employer for work. Conversely, subsection (b) explains an individual is an independent contractor under the FLSA if, as a matter of economic reality, the individual is in business for him- or herself.

Subsection (c) focuses on the two core economic reality factors listed in subsection (d)(1)— "(i) [t]he nature and degree of control over the work" and "(ii) [t]he individual's opportunity for profit or loss"—in determining whether an individual is economically dependent on an employer for work and, therefore, an employee, or in business for him-or herself and, therefore, an independent contractor. Subsection (c) explains that these two core economic reality factors "are the most probative as to whether or not an individual is an economically dependent 'employee' and each typically carries greater weight in the analysis than any other factor [listed in subsection (d)]." Subsection (c) further explains that if both core factors point towards the same classification—whether employee or independent contractor—there is a substantial likelihood that is the accurate classification.

Subsection (d)(1)(i) explains that this core factor ("[t]he nature and degree of control over the work") "weighs towards the individual being an independent contractor" if he or she "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," including the employer's competitors. Conversely, subsection (d)(1)(i) explains that this core factor weighs towards the individual being an employee if the employer "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 employer." However, subsection (d)(1)(i) states that the following actions by the employer "does not constitute control that makes the individual more or less likely to be an employee under the [FLSA]": "[r]equiring 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)."

Subsection (d)(1)(ii) explains that this core factor ("[t]he individual's opportunity for profit or loss") "weighs towards the individual being an employee [if] the individual is unable to affect his or her earnings or is only able to do so by working more hours or faster." Conversely, subsection (d)(1)(ii) explains that this core factor "weighs towards the individual being an independent contractor [if] 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." Subsection (d)(1)(ii) further explains "the individual does not need to have an opportunity for profit or loss based on both [initiative and management of investment] for this [core] factor to weigh towards the individual being an independent contractor."

Subsection (d)(2)(i) explains that this factor ("[t]he amount of skill required for the work") "weighs in favor of the individual being an independent contractor [if] the work at issue requires specialized training or skill that the employer does not provide; conversely, the factor weighs in favor of the individual being an employee [if] the work at issue requires no specialized training or skill and/or the individual is dependent upon the employer to equip him or her with any skills or training necessary to perform the job."

Subsection (d)(2)(ii) states: "This factor ["[t]he degree of permanence of the working relationship between the individual and the potential employer"] weighs in favor of the individual being an independent contractor [if] 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 [if] the work relationship is instead by design indefinite in duration or continuous." In the preamble, the DOL explains that "the seasonal nature of work would not indicate independent contractor status 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."

Subsection (d)(2)(iii) explains that this factor ("[w]hether the work is part of an integrated unit of production") "weighs in favor of the individual being an employee [if] his or her work is a component of the potential employer's integrated production process for a good or service." Conversely, "[t]his factor weighs in favor of an individual being an independent contractor [if] his or her work is segregable from the potential employer's production process." As further clarification, the preamble states, "A worker who performs a segregable step in the process of delivering a product but who is not integrated into the employer's own production process is not part of an integrated unit of production." Subsection (d)(2)(iii) further explains "that this factor is different from the concept of the importance or centrality of the individual's work to the potential employer's business[,]" which the preamble explains departs from the Supreme Court's analysis in *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 729 (1947) ("We agree with the Circuit Court of Appeals … in its characterization of their work as a part of the *integrated unit of production* under such circumstances that the workers performing the task were employees of the establishment."). (Emphasis added.)

While subsection (c) already states that the above five factors listed in subsection (d) "are not exhaustive," subsection (d)(2)(iv) makes this more explicit in stating, "Additional factors may be relevant in determining whether an individual is an employee or independent contractor for purposes of the FLSA, but only if the factors in some way indicate whether the individual is in business for him- or herself, as opposed to being economically dependent on the potential employer for work." The preamble to subsection (d)(2)(iv) explains that these unlisted additional factors "are less probative than the core factors listed in [subsection (d)(1)], while their precise weight depends on the circumstances of each case and [are] unlikely to outweigh either of the core factors."

§795.110 Primacy of actual practice. This section states: "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."

The preamble explains that this section clarifies that "unexercised powers, rights, and freedoms are not irrelevant in determining the employment status of workers under the economic reality test;" they "are merely less relevant than powers, rights, and freedoms that are actually exercised under the economic reality test."

§795.115 Examples of analyzing economic reality factors. This section contains six examples involving different industries with each example focusing on the classification favored by a specific economic reality factor (see §795.105) within the context of a fact-specific scenario.

1. The first example concerns the control factor in the context of the long-haul transportation industry.
2. The second example concerns the opportunity factor in the context of the gig economy – *i.e.*, a labor market characterized by the prevalence of short-term contracts or freelance work as opposed to permanent jobs.
3. The third example concerns the opportunity factor in the context of the construction industry and clarifies the concept of economic dependence.
4. The fourth example concerns the permanence factor within the context of a seasonal hospitality industry.
5. The fifth example concerns the integrated unit factor within the context of the journalism industry.
6. The sixth example also concerns the integrated unit factor within the context of the journalism industry and works with the fifth example to explain the distinction between when this factor favors classification as an employee versus independent contractor.

§795.120 Severability. This section provides that if a provision in part 795 is held invalid or unenforceable, or stayed pending further agency action, the provision shall be severed from part 795 and the remaining provisions shall remain effective and enforceable.

The above summary does not address every aspect or application of part 795. To gain a thorough understanding, readers are advised to read part 795 and its preamble explanations in the above hyperlinked section of the *Federal Register*.