CLIENT ALERT: U.S. Department of Labor Issues Proposed Federal Rule Easing Employers' Use of Independent Contractors – But Many States' Employers Unaffected

On September 22, 2020, the U.S. Department of Labor (DOL) issued a Notice of Proposed Rulemaking (NPRM) revising current interpretive regulations for determining whether workers are employees or independent contractors under the Fair Labor and Standards Act (FLSA). The new test will make it easier for many employers to classify workers as independent contractors. The DOL has indicated that it plans to "fast-track" the rulemaking process, and expects final regulations issued through an Executive Order by 2021.

The proposed rule adopts an "economic realities" test to assess whether a worker is economically dependent on a particular employer for work, and, therefore, an employee, or whether the worker is "in business for themselves" and can accordingly be characterized as an independent contractor. The distinction under federal law is important because under the FLSA most employees are entitled to minimum wage pay and overtime premiums. These FLSA protections do not apply to independent contractors.

While courts applying the FLSA have historically used several overlapping factors to determine employment status based on economic realities, the new rule narrows the inquiry to five distinct factors, two of which are deemed "core" and three others that are "guideposts" for analysis. The two core factors are (1) the nature and degree of the worker's control over the work; and (2) the worker's opportunity for profit or loss. Under the new rule, the DOL will consider these factors "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." Guidepost factors include (1) the amount of skill required for the work, (2) the permanence of the working relationship, and (3) the extent to which the services are an integral part of the employer's business ("integrated unit" factor).

While this rule affects U.S. employers nationally, states and other federal agencies, like the Internal Revenue Service, state worker's compensation regulators and unemployment agencies use different legal tests. For example, in Massachusetts, employers must continue to adhere to a strict "ABC Test," which makes it significantly harder to classify workers as independent contractors than under the new DOL economic realities test. Under Massachusetts wage and hour law as set forth in Section 148B of Chapter 149, a worker is presumed to be an employee unless a putative employer can demonstrate: (1) the worker is free from control and direction; (2) the service is performed outside the usual course of the business of the employer; and, (3) the worker is customarily engaged in an independently established trade, occupation, profession or business. California adopted a similar ABC test in 2019,

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potentially affecting millions more gig economy workers as well. Employers must continue to analyze the employee/contractor decision not only under the potentially new DOL test, but also more restrictive state law.

The DOL's proposed regulation is pending publication on the Federal Register, and will be available for public comment for 30 days after it is published.

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